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FOR RELEASE ON DELIVERY

Remarks of the Honorable Anthony M. Solomon
Under Secretary of the Treasury for Monetary Affairs
before the
Subcommittee on International Trade, Investment and Monetary Policy of the Committee on Banking, Finance and Urban Affairs
House of Representatives
May 1, 1979 - 10:00 A. M.

Mr. Chairman:

I am pleased to testify today in support of H.R. 3348, transmitted to the Congress on March 8, 1979, to authorize the appropriation of administrative expenses for the international affairs function of the Treasury. I will briefly explain the background of this request and outline its main elements.

Very soon after coming to the Treasury, Secretary Blumenthal and I initiated an examination of whether the administrative expenses associated with the Treasury's international responsibilities should continue to be funded from the resources of the Exchange Stabilization Fund, as they had been for decades, pursuant to the Gold Reserve Act of 1934. The financing of these expenses from the ESF had been a source of Congressional concern, and, moreover, the Treasury's international responsibilities had grown very substantially since the 1934 authorization. We concluded that administrative expenses directly tied to ESF operations comprised only a small part of the total ESF administrative budget, and that Treasury's international affairs administrative expenses could and should be subjected to the regular budgetary process.

We submitted legislation last year to terminate payment of administrative expenses from the ESF and bring these expenditures under the appropriations process. Your Committee approved that legislation with certain modifications, and it was passed near the close of the last Congress and was signed, as P.L. 95-612, by the President on November 8, 1978. That

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- Conduct price or cost analyses on negotiated procurement actions (FPR 1-3.807-2),
- Audit proposals (FPR 1-3.809(b)),
- Conduct negotiations regarding initial, revised, and final prices (FPR 1-3.811).

The first contract (TEP-6214), was awarded to ABN on a sole source basis. It appears that BEP provided ABN with current figures showing the costs the Bureau had been billing to the Department of Agriculture. This conclusion was reached by comparing the Bureau's solicitation document with ABN's offer. The solicitation document sent out already had the approximate current prices which BEP was billing the Department of Agriculture shown on the continuation sheet. It appears that ABN simply copied this information onto its offer.

While no contracts were awarded in fiscal 1976, production pursuant to prior contracts continued through that year.

Several changes have been made in Bureau of Engraving and Printing procurement practices since the Carter Administration took office in 1977. These changes were instituted by the Treasury Department and remain in effect at this time.

First, on July 21, 1977, by Transmittal No. 97, the Department amended the Treasury Procurement Regulations to require both legal review and review by the Office of the Secretary of all Bureau solicitation documents expected to exceed $100,000 and all proposed contracts that pass this threshold. The purpose of these reviews is to assure that all procurement procedures, contract documentation, and clause inclusion have been completed.

Since these procedures were initiated, the Office of the Secretary has advised the appropriate Bureau procurement officer of the results of its review, including, where appropriate, specific comments on missing contract clauses, insufficient documentation, etc. As a result, corrective actions have been made to BEP contract documents where inadequacies were identified.

Second, on January 16, 1979, procurement authority was temporarily withdrawn from the Director of the Bureau of Engraving and Printing and delegated instead to the Director, Office of Administrative Programs, Office of the Secretary, Department of the Treasury. Under this arrangement Treasury's Office of Administrative Programs has general authority over the procurement function at the Bureau. In the exercise of that authority, OAP reviews all sole source purchase orders, contracts or amendments over $5,000; purchase orders or contracts for consulting services; contractual instruments with American Bank Note Company (ABN) or with any other company with which ABN was an unsuccessful competitor; and all proposed responses to Freedom of Information Act requests for copies of contract documents.

Since these measures were instituted, there has been a general improvement in the contract placement activities of BEP, with greater assurance that requisite contract clauses are included and that procurement regulations are followed with respect to solicitation procedures and contract file documentation.

(1) (B) Q: Why were incurred cost audits not performed prior to September 1977?

A: It appears that the contracting officer did not request an incurred cost audit.

Q: What action was taken by BEP after the submission of the September 1977 audit report?

A: The profit figures from BEP Audit Report Number 1(C)-17 were forwarded to ABN by the Bureau on September 20, 1977, with a request for analysis and comment. ABN replied on September 26, disagreeing with some of the analysis of profit. The Chief, Office of Administrative Services, BEP, then wrote a memorandum on October 7 to Acting Director Seymour Berry suggesting a further joint audit by BEP and ABN to resolve accounting differences. Berry approved this and ABN acquiesced in a letter to the Bureau dated January 16, 1978. However, nothing further was done.

As the Subcommittee is also aware, on September 12, 1977 a Bureau of Engraving and Printing employee submitted a suggestion that the Bureau attempt to recover excess profits on all prior food coupon contracts with the American Bank Note Company. That suggestion cited Audit Report Number 1(C)-17.

The suggestion was referred to the Bureau's Legal Counsel, who advised, on May 9, 1978, that the statutory basis for recovery explicitly mentioned in the suggestion was not applicable to the food coupon contracts, but that the matter should be referred to the Office of Audit to see if any alternative basis for recovery could be found. On June 19, the Chief, Office of Audit, referred the matter on to the Chief, Office of Administrative Services, "for an administrative determination in connection with [his] functional responsibility as Contracting Officer."

The Chief, Office of Administrative Services, apparently declined to read the employee suggestion as extending beyond the statutory ground expressly mentioned, and recommended that it be denied. After resubmission by the employee on the broader ground that any available basis for recovery should be pursued, the suggestion was denied on December 7, 1978, by the Chief, Office of Financial Management, with the explanation:

"A. The Legal Counsel for the Bureau has determined that the renegotiation and excess profit issue does not apply to the contracts mentioned in the suggestion; and

"B. The Chief, Office of Administrative Services, has opined that the procurement practices and procedures applied by BE&P resulted in the best ABN prices obtainable under existing market conditions; the changing nature of Department of Agriculture program estimates; and consideration of the make-up comparison of manufacturing Food Coupons vs. the ABN total product mix."

On April 14, 1978, the Department recommended to BEP that its audit staff review pricing history to determine reasonableness of price. Also on that date the Department asked the Bureau to examine whether it could use one of the statutory authorities for negotiation (41 U.S.C. 252(c)(1) et seq.) to negotiate better prices and terms on future contracts. BEP is now auditing offers received on major procurements to determine whether the price is fair and reasonable.

In early 1979 Treasury's Inspector General requested a review of TEP 75-206 (TN) and TEP 77-1 (TN) as a result of his investigations. That process of review and evaluation is continuing within the Treasury Department, and a determination whether procedures for recovery of excess profits should be invoked is to be made by Treasury this summer. The Bureau has at least until September 1979 to perform a post-award audit if Treasury determines that this approach would be fruitful.

Q: What were the results of any attempts or discussion within BEP to recover excess profits by ABN?

A: Internal correspondence indicates that BEP inquiries into the feasibility of recovering excess profits on past contracts were fruitless. The Bureau should have used the past audited profits of ABN as a bargaining point in new contract negotiations, but there is no evidence in the contract files that such a procedure was instituted for the contracts which immediately followed the audit report.

(1) (C) Q: What have been the comparative profits made by ABN and USBN since company has been receiving food coupon contracts?

A: We understand that the comparative profits of the two companies have been computed by GAO and reported to the Subcommittee. GAO derived those figures from information provided by the American Bank Note Company. The only independent source that Treasury has for checking these data is the audit performed by the Bureau (Audit No. 1(C)-17) on contracts TEP 75-206 and TEP 77-1. This audit produced figures from ABN records that agree substantially with the GAO results. For this reason, Treasury has no reason to question the GAO figures for any of the contracts.

(1) (D) Q: Was the cost information submitted by ABN and USBN prior to award of contracts certified as complete, accurate, and current?

A: Cost and pricing data (Optional Form 59) are required only in the case of negotiated contracts. The ABN negotiated contracts had cost and pricing data in all cases except two: contract TEP-6214 (1971), which had no Form 59's, and TEP-75-206 (1975), which had forms dated after the date of the contract award. The U.S. Bank Note negotiated contracts had Form 59's in each case.

(1) (E) Q: What were BEP's costs of producing and distributing food coupons in 1971 at about the time of the first award of food coupon printing and distribution contract to ABN?

A: While ABN did not begin to distribute food coupons until September 1973, it is useful to compare BEP's printing costs at the time of the first contract with the price charged by ABN. The following table shows both the cost of production and the amount of billing to Agriculture for \$2 and \$3 books in FY 70, 71 and 72, the period surrounding the award of the first coupon contract (TEP-6214) to ABN. The minor differences between "cost of production" and "billing to Agriculture" arise because the Agriculture billing was based on an estimate at the beginning of each fiscal year, which varied slightly from the actual cost of production computed later during that year. The figures compare on the average very closely with the prices of $7 per 1000 for the $2 books and $5.95 per 1000 for the $3 books charged by ABN under the first contract. This met Agriculture's stipulation that it not have to pay more for food coupons produced on contract than it had been paying for BEP-produced coupons.

TABLE 1

Cost of Food Coupon Production at BEP
(per 1000 Books)

Book	FY 70	FY 71	FY 72
$2	6.77	6.83	6.85
$3	5.64	5.60	5.61
	Billing to Agriculture		
$2	7.00	6.75 1/	7.10
		6.94 2/	
$3	5.75	5.75 1/	5.95
		5.40 2/	

1/ July 1, 1970 to January 31, 1971

2/ February 1, 1971 to June 30, 1971

SOURCE: Data on record at the Office of Financial Management, BEP

Q: How were these costs determined and have they been independently verified?

A: The costs were derived from records maintained at the Bureau's Office of Financial Management. There has been no independent verification.

Q: Is there any evidence tending, directly or circumstantially, to indicate that BEP's costs were disclosed to ABN prior to such first contract award?

A: As stated above, it appears that BEP's costs were disclosed to ABN since the solicitation document (and its draft) contained a cost estimate. There is no evidence that this cost estimate was arrived at through negotiations.

(1) (F) Q: What remedies does the Government have to recover from contractors the differences between profits based upon costs actually incurred in the performance of a contract and profits based upon costs submitted by the contractor in Form 59's prior to the award of the contract?

A: Form 59's are used in connection with negotiated contracts. The Government may recover excessive profits only if there is evidence that defective cost and pricing data were submitted and that the contracting officer relied on these defective data during negotiations in order to determine whether the prices were "fair and reasonable."

Q: Do the remedies differ in the case of negotiated contracts versus those awarded on the basis of advertising?

A: Yes. In contrast to the description given in answer to the previous question, in a formally advertised procurement, cost and pricing data are not required since there are no negotiations and award is made to the lowest bidder that is deemed to be responsive and responsible. However, under FPR 1-3.214, contracts may be negotiated after advertising if it is determined that the bid prices submitted under a formally advertised solicitation are not reasonable, or have not been independently arrived at in open competition.

(1) (G) Q: What role did James Conlon and others play in selecting ABN in the first food coupon contract?

A: The early files contain correspondence from Mr. Conlon directing the contracting officer to enter into a sole-source contract with ABN. Mr. Conlon indicated that his decision was predicated on his determination that ABN, alone, had the capability to produce food coupons, by the intaglio process and at a single location, in sufficient quantity to meet the requirements.

In addition, correspondence from ABN shows that Mr. Conlon discussed with ABN executives his feeling that no other contractor had the capability to meet the requirements of the food coupon program.

Finally, it also appears that BEP personnel assisted ABN in arranging for suppliers, who were sources for BEP, to provide such materials as coupon paper, cover stock, boxes, and cartons.

Q: Is there an "in-house" cost estimate by BEP for printing and distribution of food coupons?

A: The 1970-1972 in-house cost figures for printing at the time of the award of the first contract to ABN are given in the answer to (1)(E) above. Other cost figures for food coupons, during the periods BEP printed or distributed them, are available from the Office of Financial Management at the Bureau.

Q: Did the original contract to ABN (TEP-6214) include distribution?

A: The original contract did not include distribution. At that time, distribution was done by BEP.

(1) (H) Q: What has been BEP's record of overseeing the performance of ABN and USBN in the production and distribution of food coupons in terms of accountability, inventory control and payments for production?

A: Three units within the Bureau have shared responsibility for overseeing the performance of ABN and USBN in the production and distribution of food coupons: the Office of Audit, the Office of Security, and the Production Control Division of the Office of Industrial Services.

The Production Control Division has been responsible for the Quality Assurance provisions of the contracts, and has visited the plants, verified quality and accountability records, and reviewed the companies' inhouse operations on a monthly basis since prior to 1974. Several revisions in contract provisions have been initiated to improve this program.

The Office of Security has had responsibility since 1976 for on-site inspections to verify production accountability records, control destruction of mutilated coupons, and examine physical security. Physical security and destruction surveys have been conducted monthly throughout that period. Accountability audits have been scheduled on a quarterly basis, but in practice have been performed less regularly, ranging from monthly to as infrequently as 10 months.

The Office of Audit has had responsibility for contract compliance, including production (other than Office of Security responsibilities), storage, and shipment of coupons. On-site inspections have been performed in connection with audits on an irregular basis, averaging several times per year, but with occasional fairly lengthy intervals.

During this past winter, a Treasury Department team preparing a management review of the Bureau examined the administration of the food coupon contracts to see whether they followed approved procedures. The study (and various other inquiries taking place simultaneously) raised the level of concern at BEP about the food coupon contracts and an intensive audit and inspection effort was launched by BEP in February 1979. The Office of Audit Report No. 1(C)-23 subsequently documented several weaknesses in the administration of the food coupon contracts.

First, during the first part of FY 1979, $1.1 million had been paid to ABN without proper authorization by the contracting officer on Purchase/Delivery Orders. Moreover, the Bureau had not verified the quantity of coupons delivered from the ABN factory to the ABN warehouse before making payment. This procedure was changed in February 1979, and the head of Production Scheduling for the Bureau now verifies coupon quality, while the Office of Audit staff sign receipts for delivery before payment is made. Initially the Bureau auditors had difficulty verifying delivery of coupons to the ABN warehouse because the goods were not arranged in an orderly fashion; first-in, first-out shipping procedures had not been followed, and there were many coupons in stock that dated back as far as 1974.

Second, the ABN warehouses were severly overstocked and the inventory was out of balance when compared with levels of demand for various books. This appeared to be partially a result of early-1979 Department of Agriculture orders for large amounts of some book denominations in anticipation of demand that did materialize. Two million books were found that had been rejected for quality reasons, but not designated for destruction.

Third, large amounts of materials awaiting destruction were found, and the ABN destruction facilities appeared inadequate to deal with the flow of mutilated coupons.

(2) The acquisition, cost and performance of the Magna presses manufactured by ABN (American Bank Note Co.)

(2) (A) Q: What assistance was given ABN by BEP in the development of their Magna Press program?

A: (1) We were unable to identify from BEP records any assistance which BEP may have provided ABN in development of the Magna Press program prior to the contract to purchase four presses. Repairs and modifications to the equipment after delivery to the Bureau were accomplished by both ABN and Bureau personnel. However, ABN reimbursed the Bureau for BEP costs of these repairs or modifications until BEP purchased the presses outright in July 1978.

(2) The Bureau provides engraved test plates (which look different from real currency plates) to all equipment manufacturers when presses are being built in order to ensure that the presses can actually print currency. BEP's Office of Security also indicated that they provide ink and a non-distinctive paper.

(3) Papers provided us by the Senate investigators indicate that there were equipment discussions between James A. Conlon and ABN management.

(2) (B) Q: What were the comparative costs per unit of the four Magna presses versus the two Giori Super 98 presses acquired by BEP from 1974 through 1978?

A: The comparative lease purchase costs for the Magnas and Giori Super 98's are shown below.

Press	Price Per Unit	Total
Contract Cost 4 Magna	$1,293,000.00*	$5,172,000.00*
Actual Cost 4 Magna	1,167,982.90	4,671,931.59
Contract Cost 2 Giori Super 98	1,090,176.00**	2,180,352.00**

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* The Bureau negotiated an outright purchase of the Magnas from ABN on 7/31/78 which resulted in a $500,068.41 reduction from the contract cost.

** The initial bid for the Giori Super 98 was $1,236,727 per unit. The Buy American Act required addition of six percent to the cost and another six percent was added for the work to be done in a depressed area (this made ABN the low bidder). However, Giori later indicated that the relationship of the dollar to the mark made a reduction of $60-$70,000 possible. The actual reduction was even greater resulting in the contract price per unit for the Giori presses being $202,824 less than the Magna presses ($72,002 less when adjusted for Buy American Act and depressed areas).

(2) (C) Q: What has been the comparative currency production record of the four Magna presses versus the two Giori presses since they have been in operation?

A: From July 1977 through December 1978 the comparative production is shown below.

Press	Total Production	Production Per Press
2 Giori Super 98	82,072,000	41,036,000
4 Magnas	56,350,000*	17,030,858*

These figures are skewed due to a preference for operating the Giori Super 98's. Thus when production demand is low or a shortage of printers exists the Magna presses will not be utilized.

The Assistant Superintendent of the Construction and Maintenance Division, who was the project engineer for installing the Magna presses, has stated that only two major problems remain with the Magnas. The first is the delivery gripper system for which C&M has designed a new system similar to that of the Giori presses. If this is successful all Magnas will be retrofitted with the new system. The second problem is bad gears in the ink fountain system. This appears to be a problem of the gears being made of the wrong material and not having an adequately hardened surface. C&M is attempting to correct this problem now.

For comparison purposes the percent of full days that the Magna and Giori presses were down for all reasons is shown from July 1976 to February 1979.

Equipment	Down Time
Giori Super 98's	4.1%
Magna Presses	34.3%

(2) (D) Q: Has the performance record of the Magna presses been a factor in the rising cost of U.S. currency?

A: To some extent. The cost of operating the Magna presses has averaged $0.594 per 1000 notes higher than that of the Giori Super 98's ($5.469 to $4.875). The following chart shows the components of price increase over the last two years.

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* The last Magna press was not accepted until July 21, 1978. Therefore "Total Production" was divided by 3.31 to arrive at "Production Per Press," recognizing that one of the Magnas was in production for only part of the period.

Cost Breakout of Recent Changes to Billing Rate for Currency
($ per 1000 notes)

	FY 76	FY 78	% Increase
Manufacturing	8.9886	10.224	13.7
Administrative	3.2335	4.018	24.2
Other Support	1.9620	2.447	24.7
Surcharge	.6869	1.430	30.7
TOTAL	14.8730	18.119	
Billing Rate	14.5194	18.700	

The Magna presses produce greater volume when printing the backs of currency than the fronts. (The backs are printed first; thus the paper is easier to handle.) For this reason the Bureau has scheduled the Magnas to print backs and the Gioris to print faces of currency. Thus utilization of the Magna presses has increased to 75.5 shifts per unit (with average production of 32,735 sheets per shift) during the month of March. This compares to 79.5 shifts for the Giori Super 98's (with average production per shift of 33,609 sheets) during the same period.

The increased utilization and production of the Magna presses is likely to reduce the gap between the costs of currency produced on the Magnas and Giori Super 98's.

(2) (E) In addition to the Subcommittee's requested information, Treasury Department personnel examined the contracting arrangements for the Magna presses and determined that contract TEP-74-134, awarded to ABN for $5,172,000, has the following procurement deficiencies:

- There appears to be no abstract of bids as required for formally advertised procurements (FPR 1-2.204). The file is in complete disarray and it is virtually impossible to determine which of the two bids received was the lower.

- While lease-to-ownership and purchase plans were requested from vendors,there is no indication why a straight lease plan was not requested.

- The file contains correspondence from ABN requesting clarification of certain technical and contractual items in the Invitation for Bids to which BEP quickly responded. There is no indication that other prospective bidders were given this information. In all fairness to other bidders, and in order to maintain a fully competitive environment, any information submitted to one prospective bidder should be provided to all the others.

- There is no indication that the requirement was advertised in the Commerce Business Daily (FPR 1-1.1003-2).

- The solicitation document was not designed as a formally advertised procurement or a negotiated procurement. This designation is necessary since different procurement regulations exist for each method.

(3) Private contracting for gasoline rationing coupons in 1974.

It is our understanding that three private companies with intaglio printing capability, namely ABN, USBN and Jefferies Bank Note Company, received contracts from BEP to produce substantial quantities of gas rationing coupons. It is our further understanding that a large number of these coupons became inoperative when it was discovered that the likeness of George Washington on the face of certain gas coupons was the same as that on the dollar bill and that the coupons could be used in coin change machines. In this regard:

(3) (A) Q: How many coupons were printed with the George Washington likeness -- what was the cost to the government as a result of this oversight?

A: The total number of gasoline ration coupons printed was 4.8 billion. All such coupons were printed with the likeness of George Washington. Some of those coupons were printed with inks that would be unacceptable to a change machine. The basic coupon, of course, is only one-third the size of a $1 bill.

The possibility that some coupons may be altered so as to be usable in some change machines has not cost the Government anything at this time. Since relatively inexpensive offset overprinting of identifying numbers or other materials may eliminate the possibility that gas coupons could be used in some change machines, the cost may not be substantial. Should the coupons be assigned a value of more than $1 in use, there would, of course, be no reason for the Government to incur any costs to alter them.

(3) (B) Q: BEP Audit Report #1(A)-638 states that "the unit cost rate of $1.67 per thousand coupons for gasoline ration coupons manufactured at the Bureau was more than 50 percent less than unit cost rates of $3.52 (ABN) and $4.09 (USBN) attributable to outside contractors." Was any incurred cost audit ever done to determine the rate of profit made by ABN and USBN on the gas rationing contracts? Is the cost differential typical of the lower cost of "in house" production?

A: No incurred cost audit was ever done. This cost differential is not typical of the lower cost of "in-house" production, but a substantial reason for the large disparity in costs is the extremely large difference in the quantities produced in each facility. Printing work tends to have large initial costs, which decline with increases in quantities produced. BEP's costs were predicated on production of 3.7 billion coupons, ABN's on production of 650 million, and USBN's on production of 450 million. Whether the differences in quantities fully justified the differences in prices would involve many issues of judgment.

(4) Development of ABN's Security Signature System, and the Proposal of June 20, 1977 for its sale to the BEP.

Much of the information in the possession of the Treasury Department concerning these matters has been developed by the Inspector General. That investigation was initiated on October 6, 1978 and was referred to the Department of Justice on December 18, 1978. The Department of Justice has advised the Treasury Department that the release of materials prepared at the request of the Department of Justice could be harmful to its investigation. Consequently, the following answers will not reflect the Inspector General's knowledge of matters covered.

(4) (A) Q: The role of James Conlon in the development of SSS from September 1976 to July 1, 1977.

A: The Security Signature System was a device intended to protect against counterfeiting. As proposed it was to involve the impregnation of currency with materials that would be invisible to the naked eye, yet detectable with specialized equipment.

Treasury Department records reflect that:

- Former Director James A. Conlon met with a Mr. Weitzen of the American Bank Note Company concerning this system on September 9, 1976.

- A further meeting was held on December 7, 1976 involving representatives from the Federal Reserve Board and the American Bank Note Company, Mr. Conlon, and other personnel from the Bureau of Engraving and Printing.

- Mr. Conlon wrote to Mr. Weitzen on December 22, 1976 itemizing 34 areas in which further information was needed.

- On January 17, 1977 at Boston, Massachusetts a meeting was held involving Federal Reserve, the American Bank Note Company, Mr. Conlon and one additional Engraving and Printing employee.

- On February 9, 1977 and April 21, 1977 the same individuals plus three additional Bureau of Engraving and Printing employees met at the Bureau of Engraving and Printing.

- On May 10, 1977 Mr. Conlon wrote to Mr. Thomas E. Gainer, Chairman, Subcommittee on Currency and Coin, Federal Reserve Bank of Minneopolis, to announce "[w]e have determined that the Security Signature System proposed by the American Bank Note Company is significantly superior [to a competing signature system that had been under development]. In the best interests of the government, ... I am advising the American Bank Note Company of our interest in acquiring equipment for the Bureau's manufacture of currency employing a new technology. As early as we are able to complete arrangements for this acquisition I will prepare for discussion . . . a timetable towards the availability of the first currency adapted for us on the automated currency handling equipment."

- On May 20, 1977, Mr. Conlon sent a memorandum directly to the immediate Office of the Seçretary of the Treasury, proposing a meeting for three purposes. The first of those was "[t]o brief [the] Secretary on changes to U.S. currency, involving design adjustments and a confidential treatment to assure authentication in automated currency handling." Stating that this program had originally been proposed in 1970, the memorandum stated that the Bureau had been working closely with the Federal Reserve Subcommittee on Currency and Coin, that the "Federal Reserve fully endorses the new technique as critical to the automation project", and that there were "[n]one opposed" to it. Because the items to be discussed at the meeting had never been reviewed or approved by the Under Secretary, the meeting with the Secretary was not scheduled as proposed.

- On May 31, 1977, Mr. Conlon sent a memorandum to the Under Secretary, with an attached informational memorandum for the Secretary. The memorandum to the Under Secretary stated that a meeting would no longer be necessary because of her instructions to delete two major items from his March 20 proposal, and requested that the Secretary be asked to approve certain currency design changes needed for the introduction of a new genuineness treatment, and provide signature samples for the new currency. The informational memorandum described the need for the currency design changes, attributing the "genuineness" aspects of the project to a general project that had been underway since 1970, and flatly asserting that "E&P is currently acquiring the equipment necessary for appropriate preparation of the currency."

- On June 2, 1977, Mr. Conlon met with the Secretary in a meeting arranged by the Under Secretary, who was present for at least part of the meeting. The currency design changes were presented and approved, and Mr. Conlon spontaneously offered a brief demonstration of the Security Signature System. [As described below, Mr. Conlon submitted his written retirement on June 2, 1977, to the Under Secretary. He had, however, orally notified her of his intention the previous week in a telephone conversation.]

- On June 24, 1977, Mr. Conlon wrote Governor Phillip E. Coldwell, Federal Reserve System, proposing that the Federal Reserve advance the Bureau of Engraving and Printing $13,943,060 to fund the purchase of two security signature impregnation machines. That letter stated that the Federal Reserve would save $14,372,940 over 5 years because the Bureau would avoid $5.7 million in lease-to-purchase costs and would redistribute $8.7 million of overhead costs by carrying the equipment at "zero-value".

- On July 1, 1977 Director James A. Conlon retired.

(4) (B) Q: What studies were made by BEP to justify the expense of the SSS in terms of the nature and scope of the problem of counterfeiting of U.S. currency?

A: No records have been located indicating that such studies were conducted.

(4) (C) Q: What role did the R & D Section of BEP under Richard Sennett play in the development of anti-counterfeiting technology, ink development, test paper coating, distinctive paper, etc.?

A: The research and engineering section of the Bureau of Engraving and Printing conducts extensive work in the areas listed. Records reflect that Mr. Sennett was present at several meetings listed under (4)(A) above, and reflect that some distinctive currency paper was impregnated at American Bank Note Company using the SSS technology and Federal Reserve notes were printed thereon.

(4) (D) Q: When and under what circumstances did Conlon's superiors in the Department of Treasury learn that Conlon had accepted employment with ABN? Ditto Richard Sennett?

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STATEMENT OF BETTE B. ANDERSON, UNDER SECRETARY, DEPARTMENT OF THE TREASURY, BEFORE THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

Mr. Chairman and Members of the Committee:

The Treasury Department and the Bureau of Engraving and Printing fully support and welcome these hearings. As you know, we have cooperated fully with your investigation and, within the limits of available resources, we have provided staff support to augment your efforts.

Mr. James Conlon spent ten years as the Director of the Bureau of Engraving and Printing, finally retiring in July 1977 -- approximately seven months after the Carter Administration took office. As both the Committee and the Treasury are now aware, a number of problems apparently developed in the Bureau during Mr. Conlon's tenure as Director. Treasury shares with you a firm resolve to rectify problems which have occurred. We are attacking them on several fronts.

Our focus has been on management aspects of the problem. In general, we are moving to find or develop new top Bureau managers, and to improve the information and control systems within the Bureau. We are not, I want to emphasize, taking this approach in disregard of the need to deal with past problems. Two important developments are relevant to the past.

First, over the past twenty-one months the entire Bureau management group that was associated with Mr. Conlon's Directorship has retired from the Bureau. I do not, by that statement, mean to impugn the conduct or the motives of any particular former Bureau manager. Certainly, the Bureau will miss the accumulated experience of the career employees who occupied its top three managerial levels. Nonetheless, this unprecedented turn-over marks an important transition in the Bureau's life, and we intend to legislation also authorized a sum not to exceed $24 million to be appropriated for FY 1979. The House Appropriations Subcommittee on Treasury, Postal Service, and General Government held hearings on March 22, 1979, on the sum requested (as a supplemental) for the last quarter of FY 1979, as well as the sum requested for FY 1980, in anticipation of your authorization hearing today.

As I noted earlier, the Treasury's involvement in international affairs has expanded significantly over the years. The international affairs function embraces the wide range of issues involved in formulating policies and conducting negotiations with other governments and institutions on world economic, monetary and financial problems for which the Treasury has responsibilities. As chief financial officer of the United States, the Secretary of the Treasury has major international duties assigned by the President or directed by statute. He is Governor for the U.S. in the International Monetary Fund, the World Bank and the other multilateral development banks of which we are a member. He oversees U.S. international monetary policy and operations, including operations utilizing the resources of the Exchange Stabilization Fund. He is co-Chairman of the Saudi Arabian-United States Joint Commission on Economic Cooperation; Honorary Director of the U.S.-U.S.S.R. Trade and Economic Council; co-Chairman of the U.S.-U.S.S.R. Commercial Commission; and co-Chairman of the recently formed U.S.-China Joint Economic Committee, which will coordinate and oversee the development of U.S. economic relations with the People's Republic of China. He formulates and represents the Treasury's views on policy over the range of international trade, financing, development, energy and natural resource issues. He represents the United States in discussions and negotiations of bilateral and international monetary and financial issues with other nations and closely assists the President at economic summit meetings.

Such activities as these, on the part of the Secretary and other senior Treasury officials, require highly professional staff support. There is a continuing need for knowledge and analysis of economic conditions and policies abroad, for development and representation of U.S. positions at staff level with foreign representatives, and for relating U.S. foreign economic policy activities to the national interests of the United States.

The authorization we are requesting for FY 1980 is approximately $23 million which -- despite inflation -- is slightly below the amount authorized for FY 1979. We are deeply concerned that our responsibilities be carried out efficiently, and we have made a deliberate and effective effort to control the costs of conducting Treasury's international activities. We have been less successful in some areas than in others, because of inflationary cost increases and international developments that have demanded more extensive international contact. But we are determined to limit costs and activities wherever possible and consistent with performance of our responsibilities.

Our draft bill also requests an authorization for appropriations for FY 1981, consistent with Section 607 of the Congressional Budget and Impoundment Control Act of 1974. I note that you, Mr. Chairman, have submitted a bill which restricts the authorization to FY 1980. We would prefer an authorization for both years, simply because it would permit a more orderly budget process. The problem with seeking both authorization and appropriation in the same year is largely one of timing, and the result may frequently be hearings by the appropriations committees prior to action by the authorizing committees, as has been the case this year. A two year authorization this year would enable us to maintain an orderly sequence; and, if approved, we would plan to submit a request for FY 1982 next year.

This concludes my statement, Mr. Chairman. I urge the Subcommittee to report the bill favorably both for FY 1980 and FY 1981. I would be pleased to answer any questions that you or other members of the Subcommittee may have.

emphasized the need for borrowing authority to fund purchase of equipment. One of the apparent causes of the rising costs of currency related to an expensive lease-to-purchase agreement that had been made with the American Bank Note Company for four high-speed Magna presses over the period 1974 to 1978. It appeared that the Bureau might have avoided the high cost of this arrangement if it had obtained the necessary borrowing authority or an outright appropriation. I responded by requesting that borrowing authority legislation along the lines recommended by GAO be drafted and submitted to OMB.

Other factors also contributed to the growth of the Bureau's costs at that time. Some involved rapidly rising wage rates and the increasing costs of printing materials. The poor quality of some of the new Magna presses was another. They failed to function much of the time, produced a high spoilage rate, forced the use of additional overtime, and required substantial corrective maintenance. There was no feasible escape from this difficulty, however, because we had to continue to satisfy the Federal Reserve's need for currency. Building and installing new presses would have required a one year to 18 months delay. We bowed to the inevitable, kept the faulty presses, and tried to make them work as well as possible. Presently they are used primarily to print the backs of currency.

Meanwhile, another equipment purchase proposal was brought to my attention. In the fall of 1977 I was told that the Federal Reserve was looking into the possibility of purchasing and placing in the Bureau some equipment which would provide anti-counterfeiting protection for the currency. That project had come to my attention on one previous occasion. In May of 1977 Mr. Conlon had sent the Secretary a briefing paper and requested an appointment to brief him on an anti-counterfeiting device.

In his briefing memorandum, Mr. Conlon asserted that the Bureau and the Federal Reserve had been working on the project since 1970, and that the Federal Reserve was eager to proceed. He added that the proposal was a closely held idea within the Bureau, and that even the Federal Reserve was not familiar with the technology involved.

Thus, when the idea that the Federal Reserve might purchase the equipment and help us avoid our capitalization problems came up in October, I was receptive. The supporting materials submitted by the Acting Director at the time, Mr. Berry, contained the same representations concerning the Federal Reserve's position. Thus, I felt free to contact Governor Coldwell to discuss the financing. He requested that I seek the approval of the appropriate Congressional Committees before he made a commitment. I then contacted Chairmen Chiles and Steed and obtained letters indicating that they had no objections.

When I informed Governor Coldwell of these developments, I was completely surprised to receive a reply that indicated that the Federal Reserve Board had never been asked to approve the project.

The Federal Reserve has not made an affirmative decision on the project. In the meantime, the Bureau has continued its technological research on various proposals. In addition, I have established a Task Force on Counterfeit Threat Assessment within the Treasury. That group, composed of the Secret Service, the Assistant Secretary for Enforcement and Operations, and the Bureau, is responsible for constantly assessing potential threats to our currency and monitoring proposals to deal with those threats. Naturally, that Task Force will be working closely with the Federal Reserve Board.

To deal with the contracting problems that I perceived at the Bureau, I began early to insist upon compliance with a July 1977 Department Directive that required Departmental review of all procurement contracts over $100,000. I requested a listing of all of the Bureau's outstanding contracts within that category and, during the fall of 1977, I asked that the Department's auditors examine the Bureau's contracting activities and make recommendations. I believe that the Committee has received a copy of that report. It indicates that the Bureau had begun to correct some of its faulty procedures. I requested that the Treasury auditors monitor the Bureau's progress on the recommendations. Periodic progress reports were made by the Bureau until early 1979. At that time we thought it prudent to remove the Bureau's procurement authority and vest it in Treasury's Office of Administration. The Office of Administration has subsequently delegated limited authority directly to procurement officers at the Bureau, but their actions are closely monitored by Treasury employees.

My experience in dealing with individual problems persuaded me that we needed a thorough and comprehensive review of management practices in the Bureau, with a set of recommendations for action. That review has now been completed. It outlines the following major areas for action:

- Introduction of an automated system of cost accounting under which time and attendance, production reporting, and labor distribution are drawn from a single set of entries and reconciled on a daily basis.

- Revival of the Bureau's ADP Steering Committee, development of two-year and five-year plans, and phased introduction of an eventual automated management system.

- Various alterations in current procedures for awarding, administering, and auditing contracts, with introduction of some automated data processing abilities.

- Initiation of a study of the organizational structure of the Bureau, with emphasis on developing a staffing model to be used to control the Bureau's overhead activities.

- Establishment of work and productivity measurement systems to improve control of labor use and planning, and cost-benefit analyses of all major equipment purchases to improve capital equipment use and planning.

We are in the process of reviewing the action recommendations in the Report and I would be glad to return at your convenience and report on our progress in implementing them.

Appendix*

<u>(1) The food coupon contracts to the American Bank Note Company (since 1971) and to the U.S. Bank Note Company (since 1974).</u>

(A) <u>Q: Were federal procurement regulations</u> (including, but not limited to, those providing for pre-solicitation or pre-award cost and price analyses; post-award (incurred) cost and profit audits; assessments of the adequacy of price competition; and documentation of the foregoing and other material actions, i.e., the contracting process) <u>followed in the negotiation and audit of sole source and advertised contracts for food coupon production and distribution? Apart from compliance with such regulations, did BEP adequately employ tools available to it to protect the interests of the Government?</u>

A: Treasury Department and Bureau of Engraving and Printing [hereinafter "Bureau" or "BEP"] records indicate that the Bureau began printing food coupons for the Department of Agriculture in the early 1960's. The first private production of food coupons occurred when the Bureau awarded a contract to the American Bank Note Company on November 2, 1971, to print $2 and $3 coupon books. Private production gradually increased until, in September 1976, the Bureau ceased in-house production. Since that time all food coupons have been procured from either American Bank Note Company or the United States Bank Note Company.

Our examination has revealed that a number of provisions of the Federal Procurement Regulations (FPR) were not followed in awarding these contracts. The files regarding contracts awarded from 1971 through 1975 rarely if ever contain documentation to show that the following necessary actions were taken:

- Publicize proposed procurements in the Commerce Business Daily (FPR 1-1.1003-2),

- Publicize awards of contracts, and modifications, in the Commerce Business Daily (FPR 1-1.1004),

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* This Appendix to the Statement of Under Secretary of the Treasury Bette B. Anderson has been prepared by Treasury personnel from records available within the Treasury and the Bureau of Engraving and Printing. In many instances, as reflected in the text, information was missing or limited as a result of both the passage of time and the existence of parallel investigations.

use the opportunity to build a sound management team. The selection of Mr. Harry R. Clements, who is with me today, is a first step in that direction. Mr. Clements, now Acting Director of the Bureau, joined the Bureau in January as Deputy Director after a nationwide search that was instituted on my instructions.

Second, last fall the Inspector General of the Treasury initiated a broad investigation of problems at the Bureau. This investigation includes an inquiry into the conflict of interest problems in which this Committee has a particular interest. That investigation resulted from information that was obtained internally, as well as through the good offices of this Committee. On December 18, some aspects of that investigation were referred to the Department of Justice for further action. At this time, the Inspector General is continuing his efforts, both in support of the Department of Justice and independently. Unfortunately, the referral to the Department of Justice restricts my ability to go into any detail on the Inspector General's investigation.

You have asked me to focus on matters relating to the tenure of Mr. Conlon at the Bureau. My role, as you know, has been that of coping with the management problems that we have identified within the Bureau. My ability to speak directly to the subjects you identified in your letter to me may, therefore, be somewhat limited.

As you know, my staff has been working for some time to provide the Committee's investigators with relevant documents from Bureau and Treasury files, and your investigators have had unlimited access to Bureau personnel and files since your investigation began last August. In addition, the Treasury staff has been working with the Committee staff to develop detailed answers to a list of questions prepared by your investigators. While the bulk of the information that is responsive to those questions antedates this Administration, and in some cases can no longer be fully reconstructed, I am nonetheless including it as an Appendix to my testimony in the hope that it will prove useful to your investigation.

I am also happy to respond to any questions the Committee may have concerning my personal role in supervising the Bureau since my arrival in 1977. It may be helpful, however, if I begin with a short description of some of my actions during that period. Prior to this Administration, direct responsibility for oversight of the activities of the Bureau of Engraving and Printing lay in the Assistant Secretary for Enforcement, Operations, and Tariff Affairs, who also had the responsibility for the Customs Service, the Secret Service, the Bureau of Alcohol, Tobacco, and Firearms, the Bureau of the Mint, and the Federal Law Enforcement Training Center. The Assistant Secretary reported to the Under Secretary.

Secretary Blumenthal, in April, 1977, concluded that these reporting arrangements did not permit enough direct supervision of the manufacturing bureaus. Unlike other bureaus, Engraving and Printing and the Mint are most like a business -- they produce goods. The Secretary requested that I undertake the direct oversight of these businesses as an addition to my other duties.

The Bureau of Engraving and Printing was experiencing rapidly rising costs and customer dissatisfaction. It was also clear that the Bureau was managed by a small group of individuals, a majority of whom had spent over 30 years within the Bureau and were accustomed to their own particular ways of doing things. In general, they had not been trained as managers, but had achieved their positions through the production side of the Bureau.

In addition, this management group had not been used to active oversight. One of the first steps I took was to make it clear that I would personally review all proposals the Bureau wished to present to the Secretary. I also made it clear that I would be taking an active role in other Bureau decisions. Shortly thereafter, Mr. Conlon retired.

Immediately after the departure of Mr. Conlon in July 1977, I sent two members of Treasury's staff to conduct private interviews with Bureau personnel. Those interviews indicated that the Bureau's institutional memory and overall knowledge of operations had largely been confined to one man -- retired Director Conlon. Despite recommendations in earlier management studies, Mr. Conlon had not built a strong, deep staff. This is an important problem to which we are currently addressing our attention.

As I indicated earlier, rising cost was a prime problem. For example, in February of 1977, the Federal Reserve had expressed concern about the rising costs of currency. In March, the General Accounting Office had completed a report suggesting that there was a need for statutory authority to increase capitalization at the Bureau. The GAO report had

A: Treasury records do not reflect that this information was presented to the Under Secretary, who is the direct superior of the Director, in any formal or written manner. We are unable to reconstruct this information from memory more accurately than to state that she believes that she learned of the employment of both Mr. Conlon and Mr. Sennett at the same time, and that this occurred during the late fall of 1977.

(4) (E) Q: Did Mr. Conlon consult with or receive the approval of anyone in the Treasury Department before he wrote his letters of May 10, 1977 and May 17, 1977 in which he decided to acquire the SSS from ABN?

A: No, not as far as we can determine.

(4) (F) Q: When and under what circumstances did Mr. Conlon notify the Treasury Department of his intention to retire? [It is our understanding that Conlon met with Ms. Anderson and other Treasury officials on June 2, 1977 to discuss: (1) the SSS project; (2) certain labor problems at BEP; (3) the printing of U.S. securities by private companies and; (4) a new building and printing facility for BEP. What were the results of that meeting?]

A: The recitation above could not be fully reconciled with Treasury Department records and recollections. Mr. Conlon informed the Under Secretary of his intention to retire during the last week of May in a telephone conversation. The Under Secretary requested that he confirm that statement in writing, and he did so in a letter that he delivered to her office on June 2. The Under Secretary does not recall that the four items described in this question were discussed with her at that time.

(4) (G) Q: Did Mr. Conlon seek or obtain Treasury Department approval to send his June 24, 1977 letter regarding the financing of the SSS to the Federal Reserve?

A: No.

(4) (H) Q: When Ms. Anderson wrote her November 8, 1977 letter to the Federal Reserve re SSS, did she know that Conlon had joined ABN as President of ABN Development Company?

A: As is described in the response to (D), above, it has been impossible to reconstruct that information. In any event, the Under Secretary understood the proposal for an alteration in prior funding arrangements for currency impregnation machines to be no more than a minor financial alteration of a project that had been seven years in planning, with the full concurrence of the Federal Reserve and appropriate personnel within the Treasury Department.

(4) (I) Q: What is the current status of the SSS within BEP--Treasury Department?

A: The Security Signature System is one of numerous anticounterfeiting devices and technologies that have been presented to the Treasury Department. No commitment has been made to any particular anti-counterfeiting device or technology at this time. Before any commitment was made to a particular anti-counterfeiting device or technology, thorough analysis of the need for, and practicality of the use of, that device or technology would be required.

(4) (J) Q: What official action did James Conlon and Richard Sennett take in the period from September 1, 1976 through June 30, 1977, which affected ABN, including but not limited to, actions with regard to an actual or proposed contract relationship, providing material, information, or assistance to ABN? Actions include those taken personally and instructions to subordinates.

A: Under the time constraints of our search, and the limitations associated with the lapse of time involved and the parallel investigations in progress, it is impossible to provide an exhaustive list of the actions described. Certain forms of assistance, such as provision of dies, were required under existing food coupon contractual agreements. The Bureau also provided some quantities of distinctive currency paper to ABN during the first half of 1977 in connection with the Security Signature System, but we did not find documentation establishing that such shipments were ordered by the Director.

Aside from such institutional action, the activities of Mr. Conlon in connection with the Security Signature System are detailed in the response to question (4)(A) above. Bureau documents indicate that Mr. Sennett met with an ABN representative in connection with that System on October 12, 1976, and on December 4, 1976. Subsequently, those records indicate that Mr. Sennett was present at the

December 7, 1976, meeting, the February 9, 1977, meeting, and the April 21, 1977, meeting. Those documents do not reveal what occurred at any of those meetings.

In connection with the four Magna presses obtained from ABN, Bureau documents indicate that Mr. Sennett played a substantial role in negotiating a modification of the lease-to-purchase contract, TEP-74-134(A), to provide for suspension of payments upon loss of use of the equipment due to equipment failure, during September and October, 1976. The modification was signed October 4, 1976.

On June 7, 1977, the Chief, Office of Engineering, wrote Mr. Sennett a memorandum stating that the Magna press contractor, "is over two years delinquent in performance with a history of making commitments without adequate resources to fulfill commitments. I believe a full review of the contract should be made in line with contractual requirements. After this review is completed and a plan of action formulated in line with production demands, I would recommend that the contractor be informed in detail of his obligations and consequential alternative actions under the contract." Correspondence from ABN to the Bureau's Procurement Officer, indicates that Mr. Sennett held a series of discussions with ABN in June, 1977, during which ABN made additional commitments to attempt to solve the press difficulties.

(5) Labor policies and practices of Conlon while Director of BEP.

(5) (1) Q: Did Conlon eliminate or alter apprenticeship programs in such a way that outside hiring of plate printers and other crafts could not be achieved?

A: Our examination revealed only two instances when the apprenticeship program for the skilled crafts had been altered. We could find no evidence of it being eliminated, although on one of the two occasions there was an initial proposal to suspend the apprenticeship program for a short period of time.

In 1965 the bureau instituted a Craft Opportunities Program. This program was designed to meet equal employment opportunity objectives and provide in-house opportunities for bureau non-craft employees. Instead of utilizing the Civil Service Commission Apprenticeship Registers, which were dominated by non-minority males with 10 point veterans preference, the bureau limited the apprenticeship programs in the crafts to bureau employees. The program started with the plate printers craft and eventually expanded to all other crafts, including the non-printing ones. With respect to the plate printers, there were three apprenticeship classes. The first one was in April of 1969, the second in December of 1971 and the last one was in June of 1973. Each apprentice plate printers class took in 25 employees. The last employee completed the four year apprenticeship program in April of 1978.

In August 1976, the Bureau of Engraving and Printing in evaluating its plate printer needs for the following 18 to 24 months determined that approximately 30 additional journeyman plate printers would be required by October of 1977. The requirement was attributed to an increased customer demand aggrevated by a greater than usual attrition rate of plate printers. The bureau proposed, in light of the great number of recent apprentice graduates in its journeyman work force and the imminent need for additional journeymen, to hire highly skilled pressmen, who would be given further training in intaglio printing. For well over a year bureau management and the union had discussions concerning the bureau's proposal involving the creation of an "intermediate plate printer" position using pressmen as the source of recruiting. Management had sought the union's input into qualifications, skills, and training necessary to achieve the objective. The union, however, continued to oppose the proposal in principle and offered no alternatives other than continuing an apprenticeship program (which provides journeymen four years down stream) and the hiring of die stampers (whose knowledge and skills were not considered to correspond to those required in operating sophisticated high-speed intaglio printing equipment). Initially, the bureau's proposal mentioned the suspension of the apprenticeship program. Eventually, however, the bureau committed itself to the hiring of seven apprentices per year over a four year period. The proposal became a matter of discussion between union and Treasury Department officials, as well as an exchange of correspondence between the Treasury Department and the Secretary of Labor and Mr. George Meany, President of the AFL-CIO. The proposal was eventually approved and at the present time fourteen intermediate plate printers have been hired, with a commitment for an additional 16 intermediate positions to be recruited in two groups.

The bureau has experienced difficulty in the past in hiring journeyman plate printers from the outside. The intaglio method of printing is considered to be a specialty process not commonly used because it is time consuming, expensive, and involves scarce and exacting skills. There are very few private or public printing establishments which use the method. No private firms in the metropolitan Washington, D.C. area utilize this process, except the Bureau of Engraving and Printing. The only other source of recruiting is in New York City, Chicago, Philadelphia, and California areas. (There are other bank note houses in those cities.) Canadian sources may not be utilized because of the requirement of American citizenship. The relatively small labor market, coupled with the relocation factor, often thwarted successful recruitment of journeymen.

(5) (2) Q: It is our understanding that labor officials have complained about the shrinking number of craftsmen, especially plate printers and engravers, intolerable amounts of overtime for existing craftsmen, and the inefficiency of Magna presses. They have reportedly complained that the reputation of the craftsmen has suffered but that rising costs of BEP products, such as currency, and postal stamps are the result of poor management, imprudent acquisition of Magna presses and inaccurate cost accounting. Do these allegations have merit?

A: Over the years there has been a shrinking in the number of plate printers at the Bureau of Engraving and Printing. Our examinations do not show any shrinking in the numbers in either the engravers or siderographer crafts. With respect to engravers, in June 1959 the bureau employed eight engravers; in November of 1969 it employed 14 engravers;

and, in January of 1979 it employed a total of 18 engravers. With respect to siderographers, the bureau in December of 1959 employed 4 siderographers and two apprentices, in May of 1969 it employed 4 siderographers and in May of 1978 it employed 4 siderographers. Turning to the plate printers, from 1941 through 1951 the number of plate printers varied anywhere from a low of 455 journeyman plate printers to a high of 603. During the same period the apprentices ranged from a low of 2 to a high of 41.

In 1954 and 1955 there was a plate printers RIF in the Bureau of Engraving and Printing which coincided with the introduction of high-speed presses. Consequently, in 1955 the bureau employed 377 plate printers (journeyman), in 1956 there were 292, in 1958 there were 254, and in 1959 there were 232. We found no indications of any apprentices being hired in that period of time. In February of 1969 the bureau employed 121 journeyman plate printers and 18 apprentices. In April 1979 the Bureau of Engraving and Printing employs 99 journeyman plate printers, 14 intermediate plate printers and no apprentices. However, with an authorized total strength of 136 positions, the bureau has committed 16 positions to intermediate plate printers to be hired in two groups and seven apprentices. It might be logically concluded that the shrinking in the number of the plate printers at the Bureau of Engraving and Printing was brought about by the technological advances (introduction of high-speed presses) and an unusually high rate of attritions through retirement during 1975 and 1976. As indicated in the comments to question number (1), attempts to fill the vacancies created by the high rate of attrition in 1975-76 were delayed by union resistance to the recruiting of highly skilled pressmen into intermediate plate printer positions.

There are records to indicate an extensive amount of overtime in the plate printing division at the present time. Craftsmen in that division are working a twelve hour shift seven days a week. The bureau has attempted to work with union representatives to mitigate the impact of such extensive overtime upon the employees involved.

No evidence could be found to substantiate the subjective union characterization of the reputation of the craftsman in the intaglio process. The efficiency of the Magna presses, and the rising costs of BEP products, are treated elsewhere in this response.

(6) Gifts or gratuities received by BEP employees from firms doing business with the government.

(6) (A) Q: State the identities of all present and former BEP employees who were recipients of food, refreshment, entertainment, travel, lodging or other gratuities or gifts from ABN, USBN, and other private firms or principals there of which have had proposed or actual contract relationships with BEP or other government departments and agencies.

(6) (B) Q: State the details of such expenditures, including dates, occasions, persons involved, and nature of expenditures.

(6) (C) Q: State whether receipt of such expenditures as to each employee, individually or in the aggregate, was in violation of the Department of Treasury's Minimum Standards of Conduct.

(6) (D) Q: State the identity of each employee mentioned in (A) who received reimbursement from the government for any item which they received as a gift or gratuity and state the details of each double billed item (e.g. date, amount, nature of item).

(6) (E) Q: State matters described in response to the above which the Department of Treasury has referred to the Department of Justice or with respect to which the Department of Treasury has taken internal disciplinary action.

A: Treasury records would not contain information of the type requested in (A),(B), and (C). The Inspector General's investigators may have developed information of this type from sources outside the Treasury Department. That investigation, however, was referred to the Department of Justice on December 18, 1978 and we have been advised by the Department of Justice that the release of materials prepared at its request could harm that investigation.

As to question (D), section 0.735-33 of the Department of the Treasury's Minimum Standards of Conduct prohibits the acceptance of gifts, gratuities, or entertainment from any person who (1) has, or is seeking to obtain, contractual or other business or financial relations with the Department, (2) conducts activities that are regulated by the Department, or (3) has interests that may be substantially affected by the performance of the recipient's performance of his duties. The Bureau of Engraving and Printing has no supplemental regulation, but contains a reference to this rule.

Exceptions are provided for (1) gifts, entertainment, and food "when the circumstances make it clear that obvious family or personal relationships rather than business are the motivating factors," (2) "food and refreshments of nominal value on infrequent occasions when such action occurs in the ordinary course of a luncheon or dinner meeting or other meeting or on an inspection tour where an employee may properly be in attendance." The latter exception "also applies when Treasury officials are in attendance at large organized functions which have traditionally been considered appropriate and important ones to attend because of the recognized benefit of such attendance to Treasury operations." Two additional exceptions permit loans at "customary terms" from "banks or other financial institutions", and "unsolicited advertising or promotional material . . . of nominal intrinsic value."

All matters of the type described of which the Treasury Department has knowledge, through its own investigations or through the good offices of the Subcommittee, have been referred to the Department of Justice. No internal disciplinary action can be initiated in such cases until the Department of Justice declines to prosecute a case or otherwise completes its investigation because procedures associated with disciplinary actions could prejudice the Department of Justice action. The Inspector General has stated that he is reluctant to disclose the precise nature of the matters referred because of the damage that might be done to the Department of Justice investigation.

Testimony for the
Senate Subcommittee on Investigations
H. R. Clements
May 2, 1979

Mr. Chairman and Members of the Subcommittee:

My name is Harry R. Clements. I am the Acting Director of the Bureau of Engraving and Printing, having assumed that position on the retirement of Mr. Seymour Berry on April 7, just over three weeks ago. I first joined the Bureau on January 22, when I was hired as Deputy Director. Previously I had been employed in the aerospace and general transportation industries, as well as in Federal Government.

In my short time at the Bureau I have already come in contact with people worldwide who are associated with bank note and secure document production. Among them, I find that the Bureau has an unparalleled reputation for quality work produced on an economical basis.

My own observations confirm that view. Whatever management deficiencies might have been suffered by the Bureau, as a result of the matters being explored by this Subcommittee, the injury has not been fatal.

I, therefore, am now preparing improvements in the management and operation of the Bureau with enthusiasm and high expectations of success. I would like to tell you about some of them.

Procurement and Contract Administration

The Bureau has a diverse and demanding procurement program due to the high cost of distinctive raw materials utilized in its products, the sophistication of its printing presses and support equipment, and the added responsibility in some cases of procurement of finished documents. The problem is exacerbated by the limited number of suppliers available for most of the items and services.

I believe that generally Treasury Department procurement regulations are adequate to the task. But we must be extremely careful both in the selection of suppliers and in the administration of contracts. Particular attention must be paid to sole-source procurement and the need for comprehensive program control over the activities of critical suppliers. We plan both to improve the capability of the personnel involved in these activities and to establish additional safeguards against deviations from established procedures.

I also intend to require some measure of cost effectiveness on every major procurement. Where it is not possible to obtain a sufficient number of responsive competitive bids, we will use pre-award cost criteria. Those criteria will be based upon in-house build ups, where possible. In each case, I intend to require stringent auditing compatible with the nature and type of contract. Particular emphasis will be given to the provision of exacting and comprehensive bid specifications. Analytical techniques will be amplified and coordinated with price considerations in a total systems cost evaluation. Those evaluations will be conducted by teams representing all contributing Bureau operations to ensure a balanced approach. This philosophy is currently being applied to the procurement of new presses for both currency and postage stamps applications.

Accountability

Accountability must be maintained for basic materials, dies and plates, and printed samples or products. The broad scope of Bureau operational and R&D activities requires it to deal with other Federal agencies, the U. S. private sector, and both public and private organizations in foreign countries. This makes adherence to security and accountability requirements difficult, particularly in the face of demanding time constraints for test results, and schedules for product delivery.

I intend to require that all organizations with which we interchange accountable materials demonstrate compliance with minimum requirements of accountability and security, to be determined by the Bureau. I have already issued instructions to Bureau personnel that I am to be the final approval authority for all such systems. The security and accountability manuals of the Bureau are now being updated and improved, and they will be used as models for the outside organizations.

Cost Accounting

Current Bureau budgetary and cost accounting practices are not entirely suited to industrial activity. While, for some time, we will be hampered by a lack of automated data processing programs and our inability to require the use of time clocks, I intend to improve the timeliness and usefulness of our cost accounting data with several interim measures. The first will be a comprehensive cost budgeting procedure. That procedure will require us to project future programs and resources, and will provide a basis for measuring progress and performance. Budgets, and related cost information, will be comprised of controllable elements so that productive corrective action may be undertaken. The procedure will begin with identifiable major components, and detail will be added as automated systems are developed. Eventually, controls will be extended to those major support areas and administrative activities.

The cost controls will include meaningful resource management concepts to provide individual resource managers with the tools with which to carry out their responsibilities. Since management of assets must often cross organizational lines, I intend to encourage the use of broadly structured committees. While this concept will include such classical elements as fixed assets, raw materials, indirect supplies, and programmatic labor, the philosophy will be extended to such resources as time, schedule, personnel development, technical knowledge and facilitating tools. There will be special categories of those items most subject to abuse such as travel, personal equipment, and overtime.

Research and Development

The Bureau and its colleague organizations, the Federal Reserve System and U. S. Secret Service, must be prepared to deal with counterfeit threats on a responsible basis. In recognition of some recent technological developments that may be adapted to counterfeiting, we have recently joined with England and Canada in a tri-national endeavor to assess the whole range of current and projected counterfeit threats and to develop reasonable deterrents to those anticipated to be most serious.

This group is exploring the effectiveness and economy of a number of deterrents. We intend to avoid being constrained by any one deterrence technology or conferring a monopoly on any private firm. The initial four-month effort of this activity is about to come to fruition, with submission of technical papers and policy recommendations for the three governments to consider.

Beyond this international effort to deal with certain specific problems, the Department of the Treasury has established a working committee to carry on a continuing evaluation of developments in the scientific community that could pose a threat to U. S. currency. The Bureau has been assigned the responsibility for research and development to analyze these threats and find pragmatic deterrents for them. The Secret Service will be responsible for advice on the operational aspects of these counterfeit activities, and advice of the Federal Reserve System will be sought on currency handling implications. Through this committee, we expect to reach sound decisions on currency configuration and authentication devices. The Bureau will be improving its technical capability in a wide spectrum of scientific disciplines in order to fulfill its responsibilities in these areas.

Since the advanced counterfeit threat research and development activities will demand a given dedication of resources, it will be necessary for the Bureau to be more productive in its continuing development activities. Accordingly, Bureau planning, budgeting, and management of research and development has become more stringent, and I look forward to improved achievement in these areas.

Personnel Practices and Policies

To a large extent, personnel practices and policies within the Bureau are controlled by Department-wide and Government-wide rules. In a few areas, however, management latitude can be applied to improve present practices.

The craftsmanship and talents of our organized labor unions provide a pool of information and capability which can improve overall Bureau performance. We must recognize the interest and concerns of these bargaining units, and encourage them to participate in furthering Bureau objectives. I have begun to identify these organizations' expressed needs and work with them. While formally included in some contracts now, the ability of craftsmen to advise on the configuration of, and requirements for, special equipment still needs to be nurtured.

A particularly difficult personnel problem is that of selection of population from which candidates for apprentice programs will be chosen. We must find ways to reconcile our desire to improve the opportunities for disadvantaged groups and our need for trained personnel.

The policy of the Bureau will be to open candidacy for apprenticeship programs to a population that will provide sufficient qualified candidates, while conforming to affirmative action philosophy. Opportunities, if at all possible, will be provided first to Bureau employees, then to the Department of Treasury, and only then to a wider population. The proportion of disadvantaged groups in the current Bureau employment should assure fulfillment of affirmative action goals. An important element of this philosophy will be carefully drafted requirements for the program and job classification so that the candidates will have the potential to develop the necessary skills, but without emphasis on education and experience, which may not be applicable to the job requirements.

As I mentioned earlier, cost accounting control will be utilized in administrative and support, as well as production areas. In addition to individual or unit performance criteria that will match employee levels to functional requirements, organizational structure will follow principles of proper work flow and reporting channels and adhere to accepted practice in supervisory ratios.

Auditing Practices

Historically, the Bureau has accepted extensive internal audit activity. These audits, undertaken with management approval, however, have grown beyond the resources available. Many of them have merely duplicated the responsibilities of other functions. In order to get maximum effect from the Bureau audit function, I will reduce the scope of evaluations and use them to measure conformance to policy and procedure rather than performance of routine operations. Since there are competing requirements for regular audits of internal operations and supplier activities (as well as ad hoc problems and informative unscheduled audits), I will establish a stringent priority to assure that the most important projects are undertaken first.

Conclusion

All of the changes I have described involve use of: (1) classic management techniques concerning delegation of responsibility and authority; (2) procedures that assure the participation of all levels of employees and the necessary disciplines in important decisions; (3) a plan that includes demanding operational goals, appropriate measures of progress, and necessary corrective tools; and (4) checks and balances that assure that the basic reporting system is giving inclusive and valid information. Procedures and systems that involve those persons most able to contribute will eliminate ad hoc, narrowly based and perhaps self-serving management decisions. These will assure that the potential of the Bureau of Engraving and Printing as an effective and valuable element of Government is realized.

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

FOR RELEASE AT 4:00 P.M. May 1, 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 May 10, 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 $6,225 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 February 8, 1979, and to mature August 9, 1979 (CUSIP No. 912793 2F 2), originally issued in the amount of $3,007 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated May 10, 1979, and to mature November 8, 1979 (CUSIP No. 912793 2U 9).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing May 10, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $3,101 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 Daylight Saving time, Monday, May 7, 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 May 10, 1979, in cash or other immediately available funds or in Treasury bills maturing May 10, 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 May 1, 1979

RESULTS OF AUCTION OF 10-YEAR NOTES

The Department of the Treasury has accepted $2,255 million of $6,233 million of tenders received from the public for the 10-year notes, Series A-1989, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	9.36%1/
Highest yield	9.38%
Average yield	9.37%

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	99.296
High-yield price	99.168
Average-yield price	99.232

The $2,255 million of accepted tenders includes $ 360 million of noncompetitive tenders and $1,895 million of competitive tenders from private investors, including 57% of the amount of notes bid for at the high yield.

In addition to the $2,255 million of tenders accepted in the auction process, $ 350 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 May 15, 1979.

1/ Excepting one tender of $15,000

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

FOR RELEASE ON DELIVERY

Remarks of the Honorable Anthony M. Solomon
Under Secretary of the Treasury for Monetary Affairs
before the
Subcommittee on International Finance
of the
Committee on Banking, Housing and Urban Affairs
United States Senate
May 3, 1979 10:00 A.M.

Mr. Chairman, I am pleased to appear before your Subcommittee to support S.976, the proposed budget authorization for the Treasury's international affairs function, and to discuss recent international monetary developments. I have provided the Subcommittee separately with a more extensive assessment of the operation of the international monetary system during the period July 1977 to March 1979, and have submitted written responses to the specific questions raised in your letter of April 20 to Secretary Blumenthal.

I.

BUDGET AUTHORIZATION FOR INTERNATIONAL AFFAIRS

Mr. Chairman, this Subcommittee acted favorably last year on legislation to bring the salaries and administrative expenses of Treasury's international affairs functions under the appropriations process. In last year's hearings, I explained that, pursuant to the Gold Reserve Act of 1934, salaries and other administrative expenses associated with the Treasury's international responsibilities had in the past been paid from the resources of the Exchange Stabilization Fund (ESF). Shortly after taking office, Secretary Blumenthal and I ordered a review of this practice, and concluded that the former "off-budget" and non-appropriated status of these expenditures could and should be terminated.

The legislation authorizing appropriations for these expenses was passed near the close of the last Congress and was signed, as P.L. 95-612, by the President on November 8, 1978. It authorized a sum not to exceed $24 million to be appropriated for FY 1979, and terminated the authority to use the ESF to meet administrative costs as soon as funds were made available by an appropriations act. We are at present seeking an appropriation to cover the last quarter of FY 1979 pursuant to the FY 1979 authorization.

The Treasury's international affairs function embraces the wide range of issues involved in formulating policies and conducting negotiations with other governments and institutions on world economic, monetary and financial problems for which the Treasury has responsibilities. As chief financial officer of the United States, the Secretary of the Treasury has major international duties assigned by the President or directed by statute. He is Governor for the U.S. in the International Monetary Fund, the World Bank and the other multilateral development banks of which we are a member. He oversees U.S. international monetary policy and operations, including operations utilizing the resources of the Exchange Stabilization Fund. He is co-Chairman of the Saudi Arabian-United States Joint Commission on Economic Cooperation; Honorary Director of the U.S.-U.S.S.R. Trade and Economic Council; co-Chairman of the U.S.-U.S.S.R. Commercial Commission; and co-Chairman of the recently formed U.S.-China Joint Economic Committee, which will coordinate and oversee the development of U.S. economic relations with the People's Republic of China. He formulates and represents the Treasury's views on policy over the range of international trade, financing, development, energy and natural resource issues. He represents the United States in discussions and negotiations of bilateral and international monetary and financial issues with other nations and closely assists the President at economic summit meetings.

Such activities as these, on the part of the Secretary and other senior Treasury officials, require highly professional staff support. There is a continuing need for knowledge and analysis of economic conditions and policies abroad, for development and representation of U.S. positions at staff level with foreign representatives, and for relating U.S. foreign economic policy activities to the national interests of the United States.

The authorization we are requesting for FY 1980 is approximately $23 million which -- despite inflation -- is slightly below the amount authorized for FY 1979. We are deeply concerned that our responsibilities be carried out efficiently, and we have made a deliberate and effective effort to control the costs of conducting Treasury's international activities. We have been less successful in some areas than in others, because of inflationary cost increases and international developments that have demanded more extensive international contact. But we are determined to limit costs and activities wherever possible and consistent with performance of our responsibilities.

Our draft bill also requests an authorization for appropriations for FY 1981, consistent with Section 607 of the Congressional Budget and Impoundment Control Act of 1974. We would prefer an authorization for both years, simply because it would permit a more orderly budget process. The problem with seeking both authorization and appropriation in the same year is largely one of timing, and the result may frequently be hearings by the appropriations committees prior to action by the authorizing committees. A two year authorization this year would enable us to maintain an orderly sequence; and, if approved, we would plan to submit a request for FY 1982 next year.

This concludes this part of my statement, Mr. Chairman, and I urge the Subcommittee to report the bill favorably both for FY 1980 and FY 1981.

II.

INTERNATIONAL MONETARY DEVELOPMENTS

In the exercise of your oversight responsibilities, you have asked for an assessment of the operation of the international monetary system since the last oversight hearing in October 1977.

For this purpose, it is useful to examine separately two periods of heavy pressure on the exchange markets during which the dollar depreciated sharply against the Deutschemark and the yen, and to compare these episodes with the recent period of improved market conditions.

In the six months ending March 31, 1978, the trade-weighted value of the dollar against the currencies of all other members of the OECD depreciated by 7 percent. The Deutschemark rate rose about 16 percent, while that for the yen appreciated by approximately 20 percent. These movements occurred despite substantial intervention by a number of central banks.

When the market senses that there is a risk of fairly rapid appreciation or depreciation of a currency, traders and investors try to position themselves to avoid losses or make gains by accumulating assets denominated in currencies that are expected to rise, and liabilities in currencies that are expected to fall. Thus, anticipatory moves tend to accelerate and amplify the pressures on the exchange market that may arise from other causes. The relative impacts of energy shortages on countries, relative rates of inflation, relative rates of economic growth and unused capacity, changing current account positions in deficit and surplus countries and differential interest rates are some of the more frequently cited specific causes of market pressures. Expectations as to shifts in government policy or governmental actions affecting basic conditions are particularly important.

The growing deterioration in the United States current account was probably the leading cause for dollar depreciation in the period of market stress which extended from October 1977 to March 1978. In that six-month period, the United States' current account deficit exceeded $27 billion at a seasonally adjusted annual rate, more than double the rate for the preceding six months. The U.S. economy was continuing to expand quite rapidly while growth was lagging in Germany and Japan. Much public attention was being given to the debate over the need of policies to promote expansion in the surplus countries. There were widespread misperceptions as to U.S. policy toward the dollar.

During the second period of heavy market pressure extending from July through October of 1978, the Deutschemark, yen and Swiss franc again appreciated sharply against the dollar. In percentage terms, the rise was 18 percent for the Deutschemark, 14 percent for the yen and 26 percent for the Swiss franc. Once again there was heavy central bank intervention. In this second period of severe market disorder, the pressure developed in spite of the fact that the U.S. current account position had improved so that the annual rate was only about half as large as in the previous period of pressure -- under $14 billion at an annual rate. In part, the development of market disorder in the face of this U.S. improvement can be attributed to the continuation of current account surpluses in the three major surplus countries in the range of about $25 billion a year. The major factor, however, was the growing concern about rising rates of inflation in the United States, doubts as to the degree of restraint in domestic macroeconomic policies in the United States, and fears that the U.S. authorities were not concerned about the decline of the dollar.

These fears about the appropriateness and adequacy of U.S. policy, and thus the danger that the dollar exchang rate might decline rapidly, led to large sales of dollars against DM and yen, especially in October, associated with leads and lags in commercial transactions and other forms of precautionary shifts of asset and liability positions. A few central banks, as well as some private entities, appear to have initiated policies leading to slight reductions in the proportion of their reserves held in dollars. These shifts of funds took place despite the fact that short-term interest rates were substantially higher in the U.S. than in Germany, Japan and Switzerland, implying expectations that the effect of continuing dollar decline on capital value of short-term investments would more than offset the effect of the interest rate differential. As shifts occurred, they caused rate movements which simply reinforced the expectations of further declines.

Our November 1 program -- details of which are described in our Assessment -- turned the market psychology.. There were some events -- the turmoil in Iran and the unexpectedly large increase in oil prices -- which revived the pressure temporarily. When the market saw that the U.S. and its partners in this operation -- the monetary authorities of Germany, Switzerland and Japan -- were firm, the expectations changed.

I believe the markets now accept the Administration's assurances not only that intervention on a large scale will be carried out to deal with disorderly markets, but also that bringing inflation under control has become a dominant factor in United States' domestic economic policy.

The disorder has now subsided. A good deal of the speculative movement has been reversed. The timing of payments for trade in relation to shipments seems to be returning to more normal patterns. Confidence has returned. Since November 1, the trade-weighted value of the dollar has risen against other OECD currencies by about 10 percent.

The two periods of stress that I have cited confirm that in a world of increasing interdependence in trade and great fluidity of capital movements across boundaries, divergent trends in competitive positions or in domestic macroeconomic policies are likely to be reflected quickly in the exchange markets for major currencies.

There are times when intervention on a forceful scale is needed and, in combination with sound basic policies, can be effective in combating disorder and restoring confidence. But market expectations as to future economic policies which will impact on the trade balance, future rates of inflation and prospective interest rate movements -- in sum, market confidence in government policies and government determination to prevent disorder -- are crucial.

A stable monetary system therefore is heavily dependent on sound domestic policies that restrain inflation in deficit countries and that promote noninflationary growth in surplus countries.

Let me turn to a brief look ahead. The recent increase in OPEC oil prices and the imposition of surcharges by most OPEC members have altered the general tone of the outlook for the global economy. Most importantly, an already delicate inflationary situation has been exacerbated by higher oil prices. Our current projections suggest that inflation rates outside the U.S. will quicken this year, following two years of steady decline. Adding our own inflation rates means that inflation in the OECD area could be at least one percent faster in 1979 than in 1978.

The second troubling aspect of the recent OPEC price rise concerns external balances. For the last several years steady reductions in the OPEC surplus and redistributions of deficits among oil importing countries have significantly reduced the degree of external imbalance within the global economy. Much of this improvement will be erased this year as the OPEC surplus -- which almost disappeared in the second half of last year -- will rise to something like $30 billion. The counterpart of this larger OPEC surplus will be a return to deficit of the developed countries of the OECD as a group, and a somewhat larger deficit in the non-oil LDCs. Actually most of the OPEC members are recording deficits -- the surplus is becoming increasingly concentrated in a few countries.

But the outlook is not all gloom and doom. During 1979 we should continue to see slow, steady progress in a number of important areas. We expect a substantial reduction in the disparities in economic performance among OECD countries. This is especially important in the larger countries. Somewhat faster foreign growth abroad combined with slower U.S. growth will add stability. Real growth outside the U.S. will exceed that of the U.S. for the first time since 1975.

This alteration in relative growth rates, coupled with the gains from past changes in competitive positions, will reduce external imbalances. We are already seeing very important changes in Japan and the U.S. and expect some reduction in the German surplus

In closing, I am encouraged by developments in the exchange markets since November 1 of last year. Major countries have now put into place the framework of policies agreed upon at last year's Summit meeting -- policies which seem appropriate to current circumstances. While there remain very difficult elements in the outlook, these cooperative policies are reducing some of the more disruptive payments imbalances. This will contribute to greater stability. Lasting monetary stability in our interdependent system will depend on sustained efforts to improve international cooperation, and on implementation of coordinated macroeconomic policy. We must recognize that there will be periods of stress and instability so long as there are wide divergences in national economic priorities and policies, and in relative competitive positions. Our system must accommodate those divergences and facilitate the adjustments that will inevitably be needed. If the national priorities of the advancing nations come closer to a common scale, we can expect the international monetary system to operate more smoothly than has been the case in recent years.

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

FOR IMMEDIATE RELEASE
May 2, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY DEPARTMENT EXTENDS PERIOD OF INVESTIGATION ON TITANIUM DIOXIDE FROM BELGIUM, FRANCE, WEST GERMANY AND THE UNITED KINGDOM

The Treasury Department today said that it will extend its antidumping investigation involving imported titanium dioxide from Belgium, France, West Germany, and the United Kingdom for an additional period not to exceed 90 days.

The decision was made because more time was needed to analyze the data provided before determining whether this merchandise is being sold in the United States at "less than fair value." (Sales at less than fair value generally occur when the price of merchandise sold for exportation to the United States is less than the price of such or similar merchandise sold in the home market or to third countries. If Treasury determines that sales at less than fair value occur, the case is referred to the U. S. International Trade Commission for an injury determination. An affirmative ITC decision would require dumping duties.)

Treasury also announced that in the event it withholds appraisement on this merchandise as a result of finding sales at less than fair value, the Department plans to limit the withholding period to no more than three months.

Notice of this action will appear in the Federal Register of May 3, 1979.

Imports of this merchandise from these four countries were valued at about $57.9 million in 1977.

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

FOR RELEASE UPON DELIVERY
EXPECTED AT 9:00 A.M.
THURSDAY, MAY 3, 1979

STATEMENT OF THE HONORABLE DANIEL H. BRILL
ASSISTANT SECRETARY OF THE TREASURY FOR ECONOMIC POLICY
BEFORE THE SUBCOMMITTEE ON ECONOMIC STABILIZATION
HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

Mr. Chairman, I am pleased to be here today to discuss with the Committee the Treasury Department's recent investigation of the U.S. oil import position and its impact on our national security.

Background

As you know, Mr. Chairman, the Treasury Department recently made public the result of an investigation of the national security implications of oil imports into the United States. Similar investigations were conducted in 1959 and 1975. The 1959 investigation found that oil was being imported in a manner which threatened to impair the national security, and it will come as no surprise to you that each of the subsequent findings reached the same conclusion. In fact, the 1975 and 1979 findings concluded the threat had become more serious.

Investigation

Section 232 of the Trade Expansion Act of 1962, which authorizes the Secretary of the Treasury to make these investigations, couples in paragraph (c) the national economic welfare and national defense as a part of national security. The statute, indeed, goes beyond consideration of the obvious requirement of industrial capability to supply defense needs. It requires the recognition of "...the close relation of the economic welfare of the Nation to our national security, and ... consideration of the impact of foreign competition on the economic welfare of individual domestic industries; and any substantial unemployment, decrease in revenues of government, loss of skills or investment, or other serious effects resulting from the displacement of any domestic products by excessive imports ... in determining whether such weakening of our internal economy may impair the national security." It was within this framework of analytic considerations that the investigation was conducted.

In determining the existence of a threatened impairment of the national security arising from the quantity or circumstances under which a commodity, particularly oil, is being imported, there are several factors to be considered. Initially, the commodity must be one that is essential to our national defense or is vital to the functioning of the U.S. economy. Petroleum meets both of these tests.

The Armed Forces' mobility is highly dependent upon petroleum. The Defense Production Act assures the allocation of petroleum to the Armed Forces, but at the expense of the civilian sector. In the event of a loss of supply, this could increase the effect of the loss upon the civilian sector. Assuming that domestic supply is adequate to sustain the Armed Services and the industrial support for the Armed Services, there is a wide range of economic activity that would be curtailed by any loss of supply.

In our recent 232 investigation we asked the Commerce Department to assess the damage to the economy from the 1973/1974 oil embargo. Although the embargo was not very effective and there were other factors involved, there was a significant impact upon the petrochemical industry, and the inherent uncertainties led to a significant drop in automobile sales and services associated with automobile and air travel. There also was an adverse impact in the consumer durable and housing construction sectors.

The Department of Commerce, as well as the Council of Economic Advisers and the Department of Transportation, also made an assessment of the economic impact of an oil supply interruption. I will not attempt to summarize these analyses, but each concluded that importation of petroleum at current levels threatened impairment of the national security because an interruption of supply could have severe economic impacts.

The next consideration is the chance of supply interdictions occurring. As the report of our investigation states, the United States is highly dependent for oil upon a small number of producing states located at a great distance from the United States requiring long tenuous supply lines. The result is that our imported oil supply is extremely vulnerable to interruption by terrorist activity, political upheaval, embargo, and interdiction at sea. The risk of supply loss ranging from minor to substantial must be considered as highly possible. Due to the fragile world oil supply/demand balance, even a small interruption can have impacts out of proportion to the loss of supply.

Another factor to be considered is the loss of control over the price of oil resulting from the high oil import level. We have seen a large increase in the nominal price of imported oil since 1974. As a result, the cost of imported oil to the United States has risen significantly. Our 1959 oil import bill was $1.5 billion. In 1975 it was $27 billion. In 1978 it was $42.3 billion. It is estimated that it will be about $50 billion or over in 1979. In this regard I should like to quote the Council of Economic Adviser's analysis that is a part of the Treasury report:

> At the current level of imports, each $1.00 increase in the real price of world oil increases U.S. oil costs by $4.5 billion (in 1978 dollars) and domestic inflation by 0.2 percent. The increase in the balance of trade deficit, adjusted for a partial offsetting increase in U.S. exports to OPEC, is estimated at $3.2 billion.

In the Treasury 232 investigation we concluded that our present excessive dependence upon oil is making it more difficult to achieve U.S. domestic and international economic objectives. The rising price of imported oil increases domestic inflationary pressures by directly raising costs and heightening inflationary expectations, and the resulting uncertainties inhibit business investment required for noninflationary growth.

Rising oil imports have put greater adjustment burdens on other elements of the U.S. balance of payments and greatly increases the need for expansion of exports. Excessive and growing U.S. dependence on oil imports also increases the danger of reduced confidence in the dollar and makes the dollar more vulnerable to downward pressures in the foreign exchange market. Widespread loss of confidence in the dollar could lead to sudden and large-scale international capital flows in ways that would be disruptive to our banking system and world financial markets.

The economic risks are real and can be estimated to some extent. Much more difficult to assess is the stress placed upon the social and political stability of the Nation by the economic and life style changes that could result from loss of supply or destructive pricing of oil. I think serious instability is not beyond the realm of possibilities.

President's Energy Program

The continuing threat to the national security that was identified by the Treasury Department's 232 investigation was an important consideration underlying the program announced by the President to reduce consumption and increase domestic production of oil and other sources of energy. In his message of April 5 the President announced a series of proposed conservation measures to reduce total energy demand, particularly demand for oil. I will not repeat the list of these measures; however, it is estimated that if each of these short-term measures were fully implemented, the United States, by the end of this year, could reach the President's goal of up to a 5 percent reduction in the estimated 1979 level of oil consumption.

At the same time the President also announced new initiatives for encouraging the production and development of alternative sources of energy, including, importantly, the decision to end the subsidy to oil consumption inherent in the existing controls system which has kept the price of domestically produced oil below its replacement cost. The proposal to phase out price controls by 1981 will encourage reduced consumption and the development of new domestic energy supplies.

As the Treasury 232 investigation and other Administration officials have emphasized, the development of alternative sources of energy is an important national goal. Clearly, one possible and likely alternative source of energy is synthetic fuels. Thus, the early development of the Nation's capacity to produce synthetic fuels by private industry, utilizing coal, shale, and/or biomass conversion, is consistent with the President's energy program. And, I think I should underscore the word early. It has been pointed out by many people knowledgeable in this area that a long lead time is required to bring on new technologies to the point where they can make a meaningful contribution to the Nation's energy needs.

In his report to the President on the Treasury 232 investigation, Secretary Blumenthal stated that we should provide appropriate incentives in order to encourage additional domestic production of oil and other sources of energy. The President in his April 5 energy message announced that he would seek enactment of a windfall profits tax, with receipts from this tax to be used to establish an Energy Security Trust Fund. This fund will be used to assist low-income households to offset higher costs of domestic petroleum arising from decontrol, to provide increased assistance for energy-efficient mass transit purposes, and to finance new energy initiatives and investments that will permit us to develop alternatives to imported oil. The receipts from the Energy Security Trust Fund would supplement funds that the President has already requested for energy research and technology development. The Fund will finance a program of tax credits for solar energy, woodstoves, and oil shale and the construction of a second Solvent Refined Coal demonstration plant assuming that a windfall profits tax is enacted. If tax revenues are adequate, additional initiatives to reduce imports will be proposed. The activities financed from both the Energy Security Trust Fund and the President's budget requests should provide significant results in terms of demonstrating commercial technologies that have the capability of replacing imported oil.

While the President has outlined the conceptual use of the revenues from the windfall profits tax and the Energy Security Trust Fund, all of the details have not yet been completed. As you know, Mr. Chairman, the Congress is now considering the windfall profits tax, so the exact amount of revenues from the sources is not assured.

The President's energy proposals would also encourage the development of synthetic fuels in one other way. By decontrolling the price of oil we can expect higher effective domestic oil prices. Higher prices for oil should help make synthetic fuels more competitive with oil and, therefore, provide incentive for private development and commercialization of such liquid fuels.

Mr. Chairman, this concludes my brief formal statement. I will be happy to answer any questions that you or other members of the Committee may have.

Department of the TREASURY NEWS
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FOR IMMEDIATE RELEASE May 2, 1979

RESULTS OF AUCTION OF 30-YEAR TREASURY BONDS
AND SUMMARY RESULTS OF MAY FINANCING

The Department of the Treasury has accepted $2,005 million of $4,837 million of tenders received from the public for the 30-year bonds auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	9.22%
Highest yield	9.24%
Average yield	9.23%

The interest rate on the bonds will be 9-1/8% . At the 9-1/8% rate, the above yields result in the following prices:

Low-yield price	99.039
High-yield price	98.838
Average-yield price	98.938

The $2,005 million of accepted tenders includes $162 million of noncompetitive tenders and $1,843 million of competitive tenders from private investors, including 36 % of the amount of bonds bid for at the high yield.

In addition to the $2,005 million of tenders accepted in the auction process, $200 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 May 15, 1979.

SUMMARY RESULTS OF MAY FINANCING

Through the sale of the two issues offered in the May financing, the Treasury raised approximately $2.5 billion of new money and refunded $2.3 billion of securities maturing May 15, 1979. The following table summarizes the results:

	New Issues 9-1/4% Notes 5-15-89	9-1/8% Bonds 5-15-04-2009	Total	Maturing Securities Held	Net New Money Raised
Public	$2.3	$2.0	$4.3	$1.7	$2.5
Government Accounts and Federal Reserve Banks	0.4	0.2	0.6	0.6	-
TOTAL	$2.6	$2.2	$4.8	$2.3	$2.5

Details may not add to total due to rounding.

B-1580

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

FOR IMMEDIATE RELEASE
May 3, 1979

REMARKS BY
THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE
ASIAN DEVELOPMENT BANK'S TWELFTH ANNUAL MEETING
MANILA, THE PHILIPPINES

Introduction

It is a great pleasure for me to attend the 12th annual meeting of the Asian Development Bank in the gracious and hospitable city of Manila. I would like today to reiterate the strong support the United States has expressed in previous years for the Asian Development Bank in its mission to promote growth and development in Asia. As the Bank enters the second year of its second decade, its important role as a focal point for development assistance and cooperation in an area where more than half of the world's population resides, is already well established.

The United States is deeply committed to peace, economic development and social progress in Asia as well as to a stable system of independent states in the region. We are a Pacific nation; indeed, parts of our nation stretch far into the Pacific. We are and will continue to be an integral part of this region, not only because of our geography, but because our political security and economic interests dictate that the United States remain actively involved in Asian-Pacific affairs.

Much of the Asian region has reached a new era in the field of economic development. During 1978, as pointed out in the ADB's annual report, the economic performance of most of the Bank's developing member countries was impressive -- particularly in the light of economic developments in the world generally.

B-1581

World Economic Situation and Outlook

As the developing economies of Asia grow, they are being integrated with the world economy and more closely linked to the industrialized economies outside the region. Thus, the economies of Asia share the uncertainties about the future that concern us all: significant increases in the price of energy, sluggish aggregate demand in much of the industrial world outside the United States since 1973, higher than normal rates of inflation, and increasing protectionist pressures, among others.

Nevertheless, the global economy ended 1978 on an upswing. We estimate that developed country growth increased to 4.3 percent in the second half of the year, while growth in the developing countries continued at more than 5 percent for the year.

A major concern we now have is that the oil price increases of last December and March will undo progress and exacerbate those negative trends that have persisted. We can probably expect industrial country growth rates to return in 1979 to the 3.6 percent range experienced in 1978, while rising oil prices will add to inflationary pressures in both the developed and developing countries. We can also expect the pattern of current account balances as a whole to retreat from important gains, with the OPEC surplus rising from about $5 billion to something over $20 billion this year while the deficit of the oil importing developing countries will increase by $2-3 billion.

Economic Developments in Asia

Asia continues to be marked by sharp contrasts in economic conditions and performance. It includes the fastest growing nations on the globe side-by-side with some of the slowest, where per capita growth is lost to swelling populations. A review of economic performance during 1978 shows that, in terms of major economic indicators, namely real income, food production, inflation, and trade, there were wide variations among individual countries, but the region overall registered good progress.

Real growth increases ranged from 3.0 percent for Fiji and 3.5 percent for India to 12.1 percent and 12.6 percent for Korea and Taiwan respectively. Agricultural production, perhaps the cornerstone of the regional economy, was good in 1978. Rice, wheat and maize production all rose by about 5 percent. Price increases were held to 6.2 percent -- a level many of the developed countries would envy at this time. Early estimates suggest that exports rose 17 percent to about $80 billion in 1978 while imports rose 23 percent to a projected $91 billion. The

$11 billion trade deficit was double the $5.5 billion trade deficit of the previous year, but it was easily financed by increased capital flows. Indeed, international reserves for the region rose about $5 billion to a year-end estimate of $30.8 billion, equivalent to about 4.7 months' import coverage.

United States Economic Policy

In the past twelve months the United States has undertaken a number of actions designed to promote sustained growth, fully recognizing that a strong, non-inflationary U.S. economy is a vital prerequisite to meeting our obligations to assist the developing nations and our broader responsibilities for assuring an effective functioning of the world economy.

During 1978, the U.S. output of goods and services increased in real terms by almost four and one-half percent, a considerably faster rate than the average of the other industrialized countries. We created three million American jobs and reduced our unemployment rate below six percent. On the negative side, inflation worsened in 1978. Consumer prices rose by nine percent, a substantial increase from the six and three-quarter percent price rise in 1977.

In response to these conditions, President Carter has pursued a restrained budgetary policy, curtailing the growth of Federal spending and lowering the share of America's GNP accounted for by Federal government spending. Additional efforts to reduce inflation include the deregulation of certain industries such as the airlines in order to promote more active competition, the institution of voluntary wage and price restraints, and more restrictive monetary policies.

On the energy front, we have moved to increase conservation, to decontrol domestic oil prices and to provide greater incentives to produce oil and gas. These actions will help to adjust permanently the U.S. economy to higher world oil prices which have become a fact of life. The United States has also reached agreement with 19 other oil consuming nations to reduce expected oil consumption by five percent.

These actions have been instrumental in establishing the fundamental conditions required for a sound dollar at home and abroad. The U.S. dollar is now stronger in world currency markets than at any time during the recent past. In addition, we have joined with other major industrial countries to coordinate closely on direct action in foreign exchange markets to prevent any resumption of the disorders which led to the precipitous decline of the dollar last year.

In spite of an array of economic problems and strong internal political and economic pressures favoring the adoption of inward looking protectionist measures, President Carter has made it clear that his administration will pursue a liberal trade policy as the only path to sustained economic growth.

In this regard the trade package to conclude the Tokyo Round of Multilateral Trade Negotiations, will go before the Congress shortly. As enacted, that agreement will reduce U.S. tariffs on some $40 billion of imports by about 30 percent and sharply reduce non-tariff barriers. Several parts of the agreement provide for various forms of special and differential treatment to the imports from developing countries.

The United States Policy Toward the Developing Nations

As an integral part of the world economic system, the developing nations share our interest in an open international trading and financial system, in stable international monetary arrangements, in helping to promote adequate rates of growth of global production, and in improving the economic well-being of poor peoples everywhere. This mutuality of interests reduces the usefulness of bloc approaches to relations between developed and developing countries. As President Carter concluded in a speech last year in Caracas: "Real progress will come through specific actions designed to meet specific needs--not symbolic statements by the rich countries to salve our consciences, nor by developing countries to recall past injustices."

We believe that an effective economic relationship between the industrialized and developing nations must be based on the twin principles of shared responsibility by all and right of all to participate in international economic decisions. The degree of responsibility assumed by each country will depend on ist stage of development. The developed countries must ensure that adequate concessional development assistance is provided for the poorer nations; for the advanced developing countries, we see a need for a gradual phaseout of preferential treatment that may be necessary for the poorer countries, and the beginning of active participation in efforts to assist those countries which are less well-off.

Consistent with these policy principles, the United States, in cooperation with other nations, has undertaken since 1976 a number of important actions of direct concrete benefit to the developing countries, particularly those in Asia:

-- In trade, the United States has maintained an open trading system, allowing U.S.-Asian trade to far outstrip the growth and volume of U.S. trade with any other region of the world. Two-way trade grew by 27 percent and amounted to $78 billion last year alone. Trade also continued to expand with the developing countries under the U.S. Generalized System of Preferences.

-- In the commodity field, the United States, along with other producers and consumers, recently agreed to the outlines of a market responsive buffer stock agreement for natural rubber to ensure balanced stabilization of rubber prices, related to market trends. We have made a commitment to contribute to the tin buffer stock. We expect our Congress to complete ratification of the new International Sugar Agreement within the next few months. Finally, we joined a consensus in March for a framework Common Fund agreement to facilitate the financing of commodity agreements

-- In development finance, the Carter Administration is requesting this year, from the U.S. Congress, $8.3 billion in economic development assistance for the developing countries. That includes $974 million in U.S. bilateral assistance to Asia and $419 million for the ADB.

-- in the field of energy, the United States has strongly supported a growing role for the World Bank, the regional development banks, and our own Overseas Private Investment Corporation in the search for energy throughout the developing world.

-- in food security, we have proposed the establishment of a reserve stock policy designed to assure adequate grain supplies at reasonable prices and to meet food aid commitments. U.S. farmers, acting on government incentives, have placed 33 million tons of grain in reserve. We have also requested, and hope to receive, authority this year to create a special food aid reserve of four million tons of grain.

In looking to the future, the United States intends to emphasize programs which most directly contribute to equity as well as growth. We are all painfully aware that an estimated one billion people remain mired in poverty throughout the world, and most are in Asia. A major concern of my Government is that bilateral and multilateral assistance actually reach these people to help them become productive and contributing members of their own national economies. Unless we make progress in this important area, there can be no long-term political or economic stability.

The Multilateral Development Banks

The United States views the multilateral development banks as unusually qualified to provide the effective development assistance and economic change required to move us toward commonly held development objectives. Their staffs are highly trained and experienced. The projects the banks finance are generally soundly conceived, carefully supervised and well executed. The volume and range of the banks' operations allows a development impact which is greater than that of any individual country donor. This important influence coupled with their apolitical character enables the banks to support the adoption of appropriate economic policies in recipient countries.

Because of their effectiveness, their increased attention to meeting basic human needs and directing more benefits to the poor, and their promotion of worldwide economic growth and political stability strongly support the efforts of these institutions. U.S. contributions to these banks have grown dramatically in recent years. This year the Carter Administration is requesting of the U.S. Congress appropriations for the banks of $3.6 billion, despite urgent domestic priorities and the need to cut government spending to slow inflation.

The Asian Development Bank

The advantages of channeling development assistance through the multilateral development banks are clearly evident in the ADB's development program and in its success in meeting the needs and aspirations of the developing members of Asia despite a membership encompassing a variety of historical, cultural and racial backgrounds and economic situations as broad as any region in the world.

Nowhere has the Bank been more impressive than in its efforts to expand food output through its irrigation, fisheries and feeder road projects, and other agricultural sector lending designed to better reach the poor. We are heartened to note that the percentage and volume of funds directed toward agriculture and agro-industry have increased from 11 percent or $47 million five years ago to 27 percent or $311 million in 1978. We are pleased that the Bank has committed itself to an active lending program for the agricultural sector over the next several years. In its thoughtful and comprehensive sector paper on agricultural, the Bank also recognizes that the proper distribution of the benefits of agricultural output is as important as the increase in output. Finally, the ADB has shown through its integrated approach to designing projects that it is sensitive to the particular requirements of individual developing member countries (DMCs).

I would also like to acknowledge the Bank's recent initiative in undertaking a larger role in the development of the mineral resources of its DMCs. The Bank's program is designed to assist borrowers in intensifying their efforts to exploit their non-fuel mineral and coal resources, particularly as they relate to energy development. We recognize that the level of Bank assistance to the energy sector, in particular hydropower generation, has been substantial. However, for those countries without sufficient hydro-resources or significant fossil fuel deposits, energy production at reasonable costs is a serious problem that will require investment in non-conventional energy systems. We believe the Bank can play a useful and more expanded role in this area.

The ADB's program does not foresee a role for the Bank in the exploration, prospecting and production of new sources of petroleum. This is a wise course in view of the Bank's limited resouces and the recent initiative of the World Bank in this area. Indeed, these twin initiatives by the two Banks are a good example of the complimentary nature of assistance provided by different banks in the same region.

We are also pleased that this year the Bank will inaugurate its activities in the field of population. Although the Bank is a newcomer in this area, its contribution in future years can be substantial and we look forward to the type of innovative and effective approach that the Bank has demonstrated when presented with new challenges.

The Bank has demonstrated its ability to adapt its programs to the needs of its members by incorporating, as part of normal project design procedures, technology selection compatible with the goals of the project and the availability of factors of production. This often results in technologies that conserve capital while taking advantage of the region's vast human resources.

In this regard, we note that the ADB will lend its expertise in this area to the United Nations Conference on the transfer of technology, scheduled to take place this summer. We believe that strengthening the technological capacities of the developing countries holds great promise for constructive and cooperative action, and we see a continuing vital role for the private sector in this area and thus the need for creation of a climate conducive to entrepreneurial activity in the development, transfer, and application of technology.

I would also like to note that we believe that the goals and purposes of the Bank encompass a broad range of fundamental concerns related to the development process, including recognition of human rights. We also believe that scarce development funds generally can be best utilized to promote economic and social objectives by governments which have manifested a commitment to protecting and promoting the rights of their people. As Secretary Blumenthal has emphasized, we seek to cooperate with all members in finding ways to best advance our common commitment to the protection of internationally recognized human rights including the fulfillment of basic human needs while at the same time insuring the integrity and effectiveness of all the development banks.

The ADB has been diligent in seeking to increase the effectiveness of its operational structure. I want to compliment the Bank management for the major reorganization of the operations and administration divisions of the Bank undertaken last year. These changes will, among other things, guarantee greater attention to loan implementation, an area requiring increased attention since disbursements of funds needed for project implementation, have been lagging behind commitments. The reorganization of the operations division will also strengthen the Bank's ability to formulate an integrated, region-wide development policy through the creation of a separate development policy office.

All of us look upon the Bank as the most appropriate and effective institution to formulate region-wide development priorities and to lead in drawing up a common approach to Asia's economic problems. In this regard, we encourage the Bank's efforts to coordinate with all donors and recipients in the region to assure the most efficient use of resources. The coordination session that the world bank and the ADB will hold here immediately after this meeting is a good illustration of the progress being made in this area.

An extremely important development last year, in my Government's view, was the creation of a separate post evaluation unit which reports directly to the President of the Bank. The creation of an independent post evaluation office, together with the recent strengthening of the Office of the Internal Auditor, have set the stage for the Bank to increase and expand its ability to audit and evaluate the activities of the Bank and of its borrowers. We welcome these steps taken by the ADB.

The United States also believes that it is in the best interest of all member Governments that there be made available to member Governments, and to their publics, as much information as possible regarding the operations of the Bank. We urge the Bank to review its document classification system with a view to making the maximum number of documents available on an unrestricted basis.

For the past several months we have been engaged in an oversight process with relevant Congressional committees concerning the operational procedures of the multilateral development banks. We expect that out of this process will emerge a number of suggestions designed to enhance the effectiveness of the banks. Our suggestions will deal with auditing and evaluation procedures, the availability of documentation, the banks' role in aid coordination and the banks' efforts to better "reach the poor," as well as other possible areas. We look forward to discussing our ideas with both Bank management and ADB member countries.

I also want to encourage the Bank's greatly increased ability to attract co-financing to its development projects. We believe that recent creation of a focal point within the Bank for co-financing was an important step in the right direction. Currently, however, a vast majority of the Bank's co-financing operations is with other public or international sector institutions; we hope that in the future the Bank will be equally successful in attracting co-financiers from the private sector. That type of co-financing must, of course, be carefully negotiated so that it does not result in the Bank assuming risks that properly are those of the private sector lender.

CONCLUSION

In conclusion let me reiterate that the United States views the Asian Development Bank as a creative, dynamic, important and efficient institution through which to further the economic development of a large part of Asia and the Pacific. We have been, are now, and will continue to be firm supporters of the Bank as it continues to make substantial contributions to the development of this vast and important region. The management, staff and member countries merit praise for what they have accomplished. We are confident that they will not rest on their laurels, and will continue and improve upon their fine work in the coming years.

Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

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FOR RELEASE ON DELIVERY
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May 7, 1979

STATEMENT OF EMIL M. SUNLEY,
DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY,
ON OIL COMPANY FINANCING AND PROFITABILITY
BEFORE THE SUBCOMMITTEE ON ENERGY AND FOUNDATIONS
OF THE SENATE FINANCE COMMITTEE

Mr. Chairman and Members of this Subcommittee:

I am pleased to appear today to discuss in some detail what we know about oil company profitability and financing. Without going into the specifics of the President's energy program, I will describe our estimates of the impact of this program on oil company profitability. Hopefully the testimony will provide useful background information for the Committee's consideration of the President's proposals, particularly his windfall profits tax.

The President on April 5 announced that he is phasing out Government price controls that hold down our domestic production, encourage consumption, and increase our dependence on foreign oil. However, as controls end, oil companies will reap billions of dollars of windfall profits. The President, therefore, has proposed a tax to capture these windfall profits. This tax will provide needed revenue to help those most hurt by decontrol, to improve mass transit, and to fund energy research and development.

I have included in the Appendix several tables containing basic data on the petroleum industry -- its size, structure, taxes, profitability, assets and liabilities, and sources and uses of funds. In my testimony I want to highlight the salient facts and conclusions to be drawn from those tables. As I proceed, I will make note of the limitations of the data.

In the course of previous reviews of oil industry economic statistics, I am sure you have learned there is no single completely satisfactory set of statistics by which to accurately characterize this industry. There are three basic confounding factors that create this state of affairs: vertical integration, conglomeration, and foreign operations First, although the oil and gas industry is fundamentally a collection of extractive activities, minerals must first be processed and transported before they may be used. As a result, the structure of enterprises engaged in the mineral business, including oil and gas companies, is extremely heterogeneous. At one extreme, there are some few companies wholly devoted to oil and gas extraction; but even these companies may engage in exploration and development to maintain their productive capacity. At the other extreme, there are companies which participate to a greater or lesser degree in all stages of the oil and gas business, from exploration through refining to retail distribution of petroleum products. Obviously, changes in wellhead oil and gas prices have more economic impact on the exploration through production stages of the business than on transportation, processing, and distribution. Unfortunately, none of the standard statistical series relating to the operations of enterprises popularly called "oil companies" makes distinctions between the several stages of the oil business.

Second, the mineral and fuel market expertise of oil company managements, particularly their skill in, and aptitude for, long-range investment planning, is, and has been, transferable to nonoil and gas activities. Oil companies not only engage in the closely related activities of the petrochemical industry, some also engage in coal and metal mining. Company statistics are not readily decomposed into the different lines of activity in which they engage, and this makes still more difficult the task of assessing effects of oil price policy on the economic position of "oil companies."

Third, virtually every company with significant U.S. oil production is also active abroad. Normally available company financial data do not provide a basis for clearly distinguishing domestic from foreign operations, and in those cases, such as tax returns and FTC financial surveys, where a consistently defined domestic/foreign reporting system is imposed, the classification of financial data by line of activity is still beyond reach. Moreover, since 1971, and particularly since 1973, sharp changes in the

Notes to Appendix Tables

The following tables are based on four data sources; Statistics of Income (SOI), published by the Internal Revenue Service, Department of the Treasury; Quarterly Financial Report for Manufacturing, Mining and Trade Corporations (QFR), published by the Federal Trade Commission; Survey of Current Business (Survey), published by the Bureau of Economic Analysis, Department of Commerce; and Compustat, a financial service of the Standard and Poor's Corporation. Each data source has its own scope, purpose and severe limitations, some of which are listed below. The user is advised to turn to descriptive material in these documents in conjunction with the use of data in this Appendix.

Statistics of Income. Data in the SOI are based on a stratified sample of unaudited tax return information. Industry classification generally conforms with the Enterprise Standard Industrial Classification, designed to classify single activity establishments. Returns are classified into the industry accounting for the largest portion of total receipts. Consolidated returns are generally permitted at the election of the reporting group as long as an 80 percent ownership test is met. In Appendix Table IV, taxable income is allocated between domestic and foreign operations based on foreign taxable income as reported on Form 1118 in support of foreign tax credit claimed. Taxable income and/or loss of corporations not filing this form is allocated to domestic operations. Current tax return tabulations do not permit identification of these amounts.

Quarterly Financial Report. The QFR is based on a stratified sample of Financial Reports that must be filed with the Federal Trade Commission. The reports are based on generally accepted accounting principles. However, one of the goals of the QFR is to isolate domestic from foreign operations. This has resulted in a hybrid report in which the following are important results:

(a) In general consolidation of all domestic operations owned more than 50 percent by a reporting corporation is required.

(b) Foreign entities (corporate or noncorporate), foreign branch operations, and domestic corporations primarily engaged in foreign operations are excluded.

(c) Classification by industry, based on the Enterprise Standard Industrial Classification, is a function of domestic gross receipts contributing the largest portion of total receipts. To minimize reporting burdens, smaller corporations are cycled through the sample in such a way that one-eighth of the respondents are dropped each quarter. The summation of four quarters to derive annual totals is thereby affected to an unknown degree.

Survey of Current Business. Appendix Tables VII-A and B trace the relationship between taxable income and the national income measures of earnings in the petroleum industry. The line items that represent the Bureau of Economic Analysis' (BEA) adjustments are basically those published in the aggregate in the Survey each July in Table 8.5. BEA measures profits from current domestic production, thus the exclusion of foreign income (foreign profits net of corresponding outflows are included in a separate industry, rest-of-the-world). Other adjustments include:

(1) Deletion of all domestic dividends received -- this avoids double counting of income when industries are aggregated.

(2) Depreciation vs. expense adjustment -- this capitalizes certain capital expenditures that may be deducted currently on the tax return (such as intangible drilling costs).

(3) Oil well bonus payments -- this adjustment restores to income bonus payments associated with dry holes and expensed on the return.

(4) State income tax -- income is to be measured before all income taxes.

(5) Audit -- SOI data are based on unaudited returns. This is an estimate of profit that would be disclosed if all returns were audited and the books were kept in a manner consistent with national income concepts.

<u>Compustat</u>. Compustat is a computer data service provided by a subsidiary of Standard & Poor's Corporation. Financial data, derived from Form 10K reports filed with the SEC, is organized into a common framework for approximately 3,000 large U.S. and Canadian firms. While standard accounting procedures underlie each company's financial statement, practices may vary and consistency cannot be insured. In the event of a merger, only data from the primary company is retained and the secondary company is dropped from the files. As no attempt is made to adjust the file for these changes in retained company financial data, company and industry data change discretely. The 10K data is considered final and not revised; however, prior to the receipt of a 10K preliminary data from other sources may be posted.

The sources and uses of funds statement in Table XI has been adjusted from the Compustat format by netting certain similar transactions that occur on both sides of the balance sheet, thus reducing totals. Capital expenditures have been defined as gross capital expenditures minus the sales of property, plant and equipment. Issues of long-term debt are net of reductions in long-term debt, and stock issues are defined as new stock issues less purchases of own common and preferred stock. Increases in investments have been reduced by investment sales. Modifications have also been made in the breadth of the categories reported. Operating income, defined net of investment, property and equipment sales, is composed of four items: income including extraordinary items, depreciation and amortization, deferred taxes and a residual. The excess of the total of the above sources over the above total uses represents a decrease in working capital; conversely an excess of the above described uses over sources represents an increase in working capital. The change in working capital balances the accounting for sources with that for uses.

In the balance sheets shown in Table VI, total assets are defined to more closely correspond to assets employed in the business by netting each company's accounts payable against receivables. When the difference is positive -- receivables exceed payables -- this element of working capital is part of the assets employed; when the difference is negative, trade credit helps finance the assets employed.

Return on equity reported in Table X is computed as income before extraordinary items and discontinued items divided by the sum of reported common equity plus preferred stock at book value. Return on assets is the income to equity as defined in the numerator above plus interest expense and extraordinary income or losses divided by total assets as previously defined. The return on common stock is earnings per share divided by the average of the common stock high and low. Aggregate industry rates of return on equity and assets represent the sum of industry returns divided by the sum of the corresponding denominators. For stock price fluctuations and earnings per share, company ratios are weighted by shares outstanding.

Appendix Table I-A

Gross Domestic Product

Total and Product Originating in the Petroleum Industry (Extraction and Refining)

($ billions)

Calendar year	Gross domestic product	Petroleum as percent of total	Gross Product Originating in the Petroleum Industry: Total	Employee compensation	Profit-type income	All other components	Percent distribution: Employee compensation	Profit type income
		(.. % ..)					(...... %	.......)
1965	$ 683.4	2.09%	$14.3	$ 4.2	$ 3.0	$ 7.1	29.4%	21.0%
1966	748.8	1.96	14.7	4.3	3.1	7.3	29.3	21.0
1967	791.8	2.03	16.1	4.5	4.0	7.6	28.0	24.8
1968	863.7	1.96	16.9	4.9	3.7	8.3	29.0	21.9
1969	931.1	1.84	17.1	5.2	3.0	8.8	30.4	17.5
1970	977.8	1.86	18.2	5.5	3.2	9.5	30.2	17.6
1971	1,056.8	1.74	18.4	5.7	2.6	10.0	31.0	14.1
1972	1,164.1	1.71	19.9	6.1	2.9	10.9	30.7	14.6
1973	1,297.5	1.75	22.7	6.7	4.5	11.6	29.5	19.8
1974	1,399.8	2.25	31.5	8.0	11.7	11.9	25.4	37.1
1975	1,518.3	2.21	33.5	9.6	9.8	14.1	28.7	29.2
1976	1,685.7	2.47	41.6	11.0	14.4	16.2	26.4	34.6
1977	1,869.9	2.55	47.6	12.9	16.7	18.0	27.1	35.1
1978	2,087.6	2.56	53.5p	15.3	18.4	19.7	28.6	34.4

ffice of the Secretary of the Treasury
Office of Tax Analysis

May 4, 1979

ource: Bureau of Economic Analysis (published and unpublished data)

ɔte: Profit-type return consists of proprietor's income with inventory valuation adjustment and without capital consumption adjustment, rental income of persons without capital consumption adjustment, corporate profits with inventory valuation adjustment and without capital consumption adjustment, less subsidies received. All other components include indirect business taxes and nontax liability, business transfer payments, net interest and capital consumption allowances.

- Preliminary

Appendix Table I-B

Gross Domestic Product

Total and Product Originating in Selected Industries

Calendar year	Gross domestic product originating in: Total	Petroleum extraction and refining	All other manufacturing	All other industries	Percent of gross domestic product originating in: Total	Petroleum extraction and refining	All other manufacturing	All other industries
	(.......... $ billions			...........)	(........... percent			.............)
1965	683.4	14.3	182.0	487.1	100.0	2.09	26.6	71.3
1966	748.8	14.7	201.2	532.9	100.0	1.96	26.9	71.2
1967	791.8	16.1	205.2	570.5	100.0	2.03	25.9	72.1
1968	863.7	16.9	224.9	621.9	100.0	1.96	26.0	72.0
1969	931.1	17.1	237.5	676.5	100.0	1.84	25.5	72.7
1970	977.8	18.2	232.1	727.5	100.0	1.86	23.7	74.4
1971	1056.8	18.4	243.1	795.3	100.0	1.74	23.0	75.3
1972	1164.1	19.9	268.9	875.3	100.0	1.71	23.1	75.2
1973	1297.5	22.7	299.1	975.7	100.0	1.75	23.1	75.2
1974	1399.8	31.5	303.1	1065.2	100.0	2.25	21.7	76.1
1975	1518.3	33.5	316.6	1168.2	100.0	2.21	20.9	76.9
1976	1685.7	41.6	361.2	1282.9	100.0	2.47	21.4	76.1
1977	1869.9	47.6	404.0	1418.3	100.0	2.55	21.6	75.8
1978p	2087.6	53.5p	(... 2034.1 ..)		100.0	2.56	(.. 97.4 ..)	

: of the Secretary of the Treasury May 4, 1979
:ce of Tax Analysis

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:: Bureau of Economic Analysis (published and unpublished data:

Detail may not add to totals due to rounding.

For a further description of the content of each industry see Table 6.1, <u>Survey of Current Business</u>, Bureau of Economic Analysis.

Appendix Table I-C

Constant Dollar Gross Domestic Product
Billions of 1972 Dollars

Total and Product Originating in Selected Industries

Calendar year	Gross domestic product originating in: Total	Petroleum extraction and refining	All other manufacturing	All other industries	Percent of gross domestic product originating in: Total	Petroleum extraction and refining	All other manufacturing	All other industries
	(..........	$ billions	....	.........)	(...........	percent	....	........)
1965	919.9	16.3	218.8	684.8	100.0	1.77	23.8	74.4
1966	975.6	16.9	237.1	721.6	100.0	1.73	24.3	74.0
1967	1001.9	17.4	236.7	747.8	100.0	1.74	23.6	74.6
1968	1045.7	18.3	250.1	777.3	100.0	1.75	23.9	74.3
1969	1073.1	18.5	257.7	796.9	100.0	1.72	24.0	74.3
1970	1069.8	19.5	241.1	809.2	100.0	1.82	22.5	75.6
1971	1100.3	19.6	244.5	836.2	100.0	1.78	22.2	76.0
1972	1164.1	19.9	268.9	875.3	100.0	1.71	23.1	75.2
1973	1227.4	20.2	292.8	914.4	100.0	1.65	23.9	74.5
1974	1211.0	20.0	271.9	919.1	100.0	1.65	22.5	75.9
1975	1197.5	20.1	257.0	920.4	100.0	1.68	21.5	76.9
1976	1264.3	20.4	282.8	961.1	100.0	1.61	22.4	76.0
1977	1325.3	21.5	300.8	1003.0	100.0	1.62	22.7	75.7
1978p	1377.5	22.7	(... 1354.8	..)	100.0	1.65	(... 98.4	...)

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ource: Bureau of Economic Analysis (published and unpublished data)

ote: Detail may not add to totals due to rounding.

For a further description of the content of each industry see Table 6.1, Survey of Current Business, Bureau of Economic Analysis.

Calendar Year 1975

Petroleum Refining and Integrated Companies 1/

($ millions)

Statistics of Income

Asset size (. $ millions .)	Stock holders' equity	Income subject to tax	Net federal income tax	Taxable income after tax	Worldwide sales	Taxable income per dollar of stock-holders' equity	Taxable income after tax per dollar of stock-holders' equity	Taxable income per dollar of sales	Number of returns
Under $5 million	$ 250	$ 57	$ 22	$ 35	$ 1,273	22.8%	14.0%	4.5	1,509
5 under 10	63	23	10	13	355	36.5	20.6	6.5	22
10 under 25	208	44	16	28	745	21.1	13.5	5.9	26
25 under 50	116	56	25	31	864	48.3	26.7	6.5	10
50 under 100	786	181	76	105	2,611	23.0	13.4	6.9	12
100 under 250	882	102	38	64	4,399	11.6	7.3	2.3	15
250 or more	85,992	15,559	1,877	13,682	249,232	18.1	15.9	6.2	28
Total	$88,297	$16,022	$2,064	$13,958	$259,479	18.6%	15.8%	6.2%	1,622

Quarterly Financial Report

Asset size (. $ millions .)	Stock holders' equity	Net income before tax	Provision for income tax	Net income after tax	Sales (Domestic)	Net income before tax per dollar of stock-holders' equity	Net income after tax per dollar of stock-holders' equity	Net income per dollar of sales	Number of returns
Under $5 million	$ 218	$ 63	$ 24	$ 39	$ 981	28.9%	17.9%	6.4%	
5 under 10	40	34	16	18	191	85.0	45.0	17.8	
10 under 25	153	85	34	51	1,202	55.6	33.3	7.1	
25 under 50	140	44	21	23	542	31.4	16.4	8.1	
50 under 100	166	77	36	41	1,011	46.4	24.7	7.6	
100 under 250	1,166	241	102	139	4,875	20.7	11.9	4.9	NOT
250 or more	74,047	12,763	3,771	8,992	112,955	17.2	12.1	11.3	AVAILABLE
Total	$75,930	$13,307	$4,004	$9,303	$121,757	17.5%	12.3%	10.9%	

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Sources: Statistics of Income -- Tax return data compiled by the Statistics Division, Internal Revenue Service.
Quarterly Financial Report -- Financial reports filed with the Federal Trade Commission.

1/ Excludes companies classified in the oil and gas extraction industry. Includes coal products. Classification is based on the Enterprise Standard Classification Manual.

Appendix Table III

Petroleum Extraction and Refining

Selected Tax Return Income Statement Items by Legal Form of Business

($ millions)

	1973					1974					1975					1976p				
	Corporations	Sole proprietors	Partnerships	Total	Percent corporate (%)	Corporations	Sole proprietors	Partnerships	Total	Percent corporate (%)	Corporations	Sole proprietors	Partnerships	Total	Percent corporate (%)	Corporations	Sole proprietors	Partnerships	Total	Percent corporate (%)
Total receipts ..	145,688	1,571	1,182	148,441	98.1	313,487	2,448	2,367	318,302	98.5	311,758	2,910	2,839	317,507	98.2	367,086	3,222	3,886	374,194	98.1
Sales	139,074	1,540	1,082	141,696	98.1	304,648	2,382	2,233	309,263	98.5	303,088	2,843	2,627	308,558	98.2	354,705	3,147	3,499	361,351	98.2
Other	6,614	31	100	6,745	98.1	8,839	66	134	9,039	97.8	8,670	67	212	8,949	96.9	12,381	75	387	12,843	96.4
Total deductions.	131,991	1,616	1,750	135,357	97.5	276,686	2,169	2,638	281,493	98.3	272,261	2,660	3,468	278,389	97.8	319,735	3,031	3,266	326,032	98.1
Costs of sales & operations.	97,702	285	283	98,270	99.4	228,065	366	468	228,899	99.6	229,137	483	604	230,224	99.5	270,755	510	543	271,808	99.6
Depletion	6,160	194	124	6,478	95.1	14,456	332	350	15,138	95.5	1,669	353	234	2,256	75.0	1,607	428	107	2,142	75.0
Other	28,129	1,137	1,343	30,609	91.9	34,165	1,471	1,820	37,456	91.2	41,455	1,824	2,630	45,909	90.3	47,373	2,093	2,616	52,082	91.0
Net income (less loss) ...	13,683	-45	-568	13,070	104.7	36,787	279	-271	36,795	100.0	39,476	251	-629	39,098	101.0	48,827	191	619	49,637	98.4
Net income ..	14,032	219	265	14,516	96.7	37,094	536	737	38,367	96.7	39,931	588	1,027	41,546	96.0	49,568	636	1,755	51,959	95.4
Net loss	350	264	833	1,447	24.2	307	257	1,008	1,572	19.5	455	337	1,657	2,449	18.6	741	445	1,136	2,322	31.9
Number of returns (thou.)	8	50	13	71	11.3	9	49	12	70	12.9	9	49	13	71	12.7	10	53	15	78	12.8

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1/ Includes constructive taxable income from related foreign corporations.

Source: Corporation and Business Statistics of Income.

p - Preliminary

Appendix Table IV

Income and Taxes -- Foreign Versus Domestic
(Based on tax returns)
Corporations

($ millions)

	1972			1975			1976p		
	Foreign operations (as reported on Form 1118 in support of foreign tax credit claimed)	Domestic operations	Total	Foreign operations (as reported on Form 1118 in support of foreign tax credit claimed)	Domestic operations	Total	Foreign operations (as reported on Form 1118 in support of foreign tax credit claimed)	Domestic operations	Total
Crude petroleum and natural gas extraction:									
Income subject to tax	2,921	300	3,221	20,985p	1,139	22,124	27,525	1,409	28,934
United States Federal income tax, gross 3/	1,402 1/	139	1,541	10,073 1/	528	10,601	13,212	643	13,855
Credits claimed, total	1,394	19	1,413	10,073	76	10,149	13,191	98	13,289
Foreign tax credit	1,394	--	1,394	10,073	--	10,073	13,191	--	13,191
Investment tax credit 2/	--	19	19	--	75	75	--	98	98
Other credits	--	--	--	--		*	--	--	--
United States Federal income tax, net	8	120	129	--	453	452	21	545	566
Effective tax rate	0.3%	40.0	4.0	--	39.8	2.0	0.1	38.7	2.0
Petroleum refining (including integrated):									
Income subject to tax	3,839	721	4,560	10,806p	5,216	16,022	8,925	8,784	17.709
United States Federal income tax, gross 4/	1,842 1/	451	2,293	5,187 1/	2,454	7,641	4,284	4,134	8,418
Credits claimed, total	1,559	132	1,691	5,067	509	5,577	4,093	1,058	5,151
Foreign tax credit	1,559	--	1,559	5,067	--	5,067	4,093	--	4,093
Investment tax credit 2/	--	132	132	--	509	509	--	1,042	1,042
Other credits	--	*	*	--	*	*	--	16	16
United States Federal income tax, net	283	319	602	120	1,945	2,064	191	3,076	3,267
Effective tax rate	7.4%	44.2	13.2	1.1	37.3	12.9	2.1	35.0	18.4

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Source: Corporation Statistics of Income and Treasury estimates.
p - Preliminary
1/ Assumed to accrue at 48 percent.
2/ Allocated to domestic operations.
3/ Includes (under domestic operations) additional tax for tax preferences: 1972, $9 million, 1975, $15 million, 1976, $25 million).
4/ Includes (under domestic operations) additional tax for tax preferences: 1972, $166 million, 1975, $32 million, 1976, $ million).

Note: 1) For a particular firm, net U.S. liability on foreign operations may by offset by negative liability due to domestic losses.
2) Foreign losses of firms not claiming a foreign tax credit and therefore, not reported as part of Form 1118 taxable income (less loss) will be reflected in the domestic operations column.

Selected Balance Sheet and Income Statement Items as Measured in Financial Reports
Filed with the Federal Trade Commission

Petroleum Refining and Integrated Companies 1/

($ millions)

	Calendar Years 1974	1975	1976	1977	1978
Balance sheet:					
Assets	$114,819	$122,667	$143,017	$155,462	$171,374
Cash, U.S. Government and other securities	10,077	9,421	10,683	8,346	8,841
Inventories	7,451	8,050	10,368	12,734	12,670
Depreciable and amortizable fixed assets including construction work in progress	76,701	84,061	96,827	108,891	122,766
Deduct: Accumulated depreciation, depletion, and amortization	41,770	45,314	50,413	54,091	60,120
All other assets	62,360	66,449	75,552	79,582	87,217
Liabilities	42,374	46,738	56,885	63,360	73,036
Long-term debt due in more than one year	14,352	16,237	20,606	23,810	24,299
Other liabilities	28,022	30,501	36,279	39,550	48,737
Stockholders' equity	72,445	75,929	86,133	92,103	98,337
Income statement:					
Net sales, receipts, and operating ratios	113,496	121,762	141,345	162,291	177,738
Income (or loss) before income taxes and extraordinary items.	14,425	11,670	14,573	15,072	15,548
Provision for current and deferred domestic income taxes:					
Federal	2,831	3,618	4,700	5,130	5,682
State and local	404	387	476	482	606
Net income (or loss) of foreign branches and equity in earnings (or losses) of domestic and foreign nonconsolidated entities and investments accounted for by the equity method, net of foreign taxes	3,293	1,640	2,330	2.718	3,535
Income (or loss) after income taxes	14,483	9,307	11,725	12,179	12,795
Cash dividends charged to retained earings	3,949	4,245	4,479	5,007	5,443
Operating ratios:					
Rate of profits on stockholders equity at end of period					
Before income taxes	24.5%	17.5%	19.6%	19.3%	19.4%
After income taxes	20.0	12.3	13.6	13.2	13.0
Ratio of long-term debt to equities at end of period	19.8	21.4	23.9	25.9	24.7

Office of the Secretary of the Treasury, Office of Tax Analysis — May 2, 1979

1/ Excludes companies classified in the oil and gas extraction industry. Includes coal products. Classification is based on the Enterprise Standard Industrial Classification.

Appendix Table V-B

Selected Balance Sheet and Income Statement Items as Measured in Financial Reports Filed with the Federal Trade Commission

All Other Manufacturers

($ millions)

	Calendar Years				
	1974	1975	1976	1977	1978
Balance sheet:					
Assets	$654,135	$688,243	$740,843	$807,534	$914,976
Cash, U.S. Government and other securities	37,180	49,265	58,736	59,877	62,012
Inventories	172,251	165,907	176,662	187,762	210,547
Depreciable and amortizable fixed assets including construction work in progress	385,051	414,330	439,633	476,085	527,651
Deduct: Accumulated depreciation, depletion, and amortization	192,712	205,683	217,574	232,210	252,968
All other assets	252,365	264,424	283,386	316,020	367,734
Liabilities	318,215	328,716	351,636	387,909	450,134
Long-term debt due in more than one year	115,767	128,962	132,954	143,453	157,442
Other liabilities	202,448	199,754	218,682	244.456	292,692
Stockholders' equity	335,920	359,527	389,206	419,624	464,844
Income statement:					
Net sales, receipts, and operating ratios	947,067	943,453	1,061,888	1,165,772	1,320,099
Income (or loss) before income taxes and extraordinary items.	67,727	59,816	79,167	87,949	101,116
Provision for current and deferred domestic income taxes:					
Federal	27,041	23,496	31,181	34,538	39,722
State and local	3,119	3,293	4,045	4,595	5,396
Net income (or loss) of foreign branches and equity in earnings (or losses) of domestic and foreign nonconsolidated entities and investments accounted for by the equity method, net of foreign taxes	6,697	6,801	8,851	9,372	12,521
Income (or loss) after income taxes	44,264	39,828	52,794	58,187	68,519
Cash dividends charged to retained earings	15,518	15,723	18,284	21,578	23,517
Operating ratios:					
Rate of profits on stockholders equity at end of period:					
Before income taxes	22.2%	18.5%	22.6%	23.2%	24.4%
After income taxes	13.2	11.1	13.6	13.9	14.7
Ratio of long-term debt to equities at end of period	34.5	35.9	34.2	34.2	33.9

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Integrated Petroleum and Refining Companies
(amounts in $ millions)

	1969		1970		1971		1972		1973	
	AMOUNT	PCT.	AMOUNT	PCT.	AMOUNT	PCT.	AMOUNT	PCT.	AMOUNT	PCT.
ASSETS										
TOTAL	85488.597	1.00	92296.494	1.00	100223.353	1.00	106635.067	1.00	118263.883	1.00
ADJ. CURRENT	15445.420	.18	16786.324	.18	18322.249	.18	19664.449	.18	27121.569	.23
PLANT (NET)	60665.878	.71	65250.064	.71	70143.305	.70	74258.304	.70	78332.296	.66
INVESTMENTS	7998.508	.09	8696.018	.09	9903.690	.10	10404.034	.10	10676.216	.09
INTANGIBLES	176.620	.00	207.570	.00	219.497	.00	181.508	.00	163.382	.00
ALL OTHER	1202.172	.01	1356.520	.01	1634.614	.02	2126.773	.02	1970.421	.02
LIABILITIES										
TOTAL	85488.597	1.00	92296.494	1.00	100223.353	1.00	106635.067	1.00	118263.883	1.00
ADJ. CURRENT	3326.749	.04	4067.327	.04	5201.402	.05	5957.832	.06	8040.262	.07
LN-TERM DEBT	15771.411	.18	18041.618	.20	19983.205	.20	20905.019	.20	21557.319	.18
DEFERRED TX.	2899.059	.03	3260.071	.04	3580.258	.04	4055.792	.04	4978.080	.04
NET WORTH	63491.378	.74	66927.479	.73	71458.488	.71	75716.425	.71	83688.223	.71

	1974		1975		1976		1977	
	AMOUNT	PCT.	AMOUNT	PCT.	AMOUNT	PCT.	AMOUNT	PCT.
ASSETS								
TOTAL	145616.107	1.00	157314.389	1.00	176993.889	1.00	197877.490	1.00
ADJ. CURRENT	43284.396	.30	43111.472	.27	48650.733	.27	51337.212	.26
PLANT (NET)	89089.233	.61	97803.859	.62	111114.229	.63	127937.887	.65
INVESTMENTS	10811.078	.07	13046.921	.08	13372.126	.08	14443.786	.07
INTANGIBLES	122.654	.00	170.514	.00	117.270	.00	134.326	.00
ALL OTHER	2308.750	.02	3181.625	.02	3739.533	.02	4024.283	.02
LIABILITIES								
TOTAL	145616.107	1.00	157314.389	1.00	176993.889	1.00	197877.490	1.00
ADJ. CURRENT	18340.928	.13	17957.892	.11	21618.893	.12	22562.013	.11
LN-TERM DEBT	23995.426	.16	30700.388	.20	36936.113	.21	42331.300	.21
DEFERRED TX.	6358.958	.04	8366.730	.05	10162.838	.06	12316.301	.06
NET WORTH	96920.797	.67	100289.381	.64	108276.045	.61	120667.877	.61

Appendix Table VI
Balance Sheet Items, 1969-1977 Oil and Gas Extraction Companies
(amounts in $ millions)

	1969 AMOUNT	1969 PCT.	1970 AMOUNT	1970 PCT.	1971 AMOUNT	1971 PCT.	1972 AMOUNT	1972 PCT.	1973 AMOUNT	1973 PCT.
ASSETS										
TOTAL	6242.165	1.00	6922.079	1.00	7564.700	1.00	8386.287	1.00	9558.634	1.00
ADJ. CURRENT	978.393	.16	1071.169	.15	1074.255	.14	1283.134	.15	1565.191	.16
PLANT (NET)	4191.792	.67	4671.703	.67	5200.194	.69	5804.700	.69	6613.616	.69
INVESTMENTS	886.588	.14	964.546	.14	1015.936	.13	972.042	.12	975.038	.10
INTANGIBLES	61.838	.01	65.483	.01	70.200	.01	75.192	.01	74.066	.01
ALL OTHER	123.554	.02	149.178	.02	204.115	.03	251.120	.03	330.723	.03
LIABILITIES										
TOTAL	6242.165	1.00	6922.079	1.00	7564.700	1.00	8386.287	1.00	9558.634	1.00
ADJ. CURRENT	264.889	.04	343.249	.05	382.665	.05	460.711	.05	565.941	.06
LN-TERM DEBT	1420.696	.23	1629.867	.24	1808.947	.24	2196.072	.26	2324.145	.24
DEFERRED TX.	83.561	.01	144.595	.02	170.746	.02	160.812	.02	223.051	.02
NET WORTH	4473.019	.72	4804.368	.69	5202.342	.69	5568.692	.66	6445.497	.67

	1974 AMOUNT	1974 PCT.	1975 AMOUNT	1975 PCT.	1976 AMOUNT	1976 PCT.	1977 AMOUNT	1977 PCT.
ASSETS								
TOTAL	11492.282	1.00	13201.963	1.00	15266.569	1.00	17612.108	1.00
ADJ. CURRENT	2180.156	.19	2581.158	.20	2773.982	.18	2891.806	.16
PLANT (NET)	7990.712	.70	9405.793	.71	11043.503	.72	13153.103	.75
INVESTMENTS	861.160	.07	843.702	.06	850.863	.06	934.510	.05
INTANGIBLES	44.016	.00	38.121	.00	23.459	.00	14.845	.00
ALL OTHER	416.238	.04	333.189	.03	574.762	.04	617.844	.04
LIABILITIES								
TOTAL	11492.282	1.00	13201.963	1.00	15266.569	1.00	17612.108	1.00
ADJ. CURRENT	892.474	.08	1002.835	.08	999.091	.07	1109.850	.06
LN-TERM DEBT	2664.251	.23	2928.177	.22	3637.998	.24	4002.762	.23
DEFERRED TX.	421.425	.04	801.320	.06	999.706	.07	1469.901	.08
NET WORTH	7514.132	.65	8469.631	.64	9629.774	.63	11029.895	.63

Corporations Classified in the Crude Petroleum and Natural Gas Extraction Industry
Reconciliation of Taxable Income Per Returns and Pretax Earnings Per National Income and Product Accounts

($ millions)

	Calendar Years											
	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976p
Corporation Statistics of Income:												
Income subject to tax	882	1,060	1,091	1,228	1,253	1,398	2,141	3,221	6,028	23,494	22,124	28,934
Plus:												
Net operating loss deduction	53	33	77	57	59	43	68	56	92	207	115	183
Dividends received deduction	17	12	15	18	13	15	45	29	49	43	29	66
WHT deduction	5	1	1	2	1	2	3	3		8	9	16
DISC and Subchapter S net income	27	17	15	14	12	12	22	18	39	80	73	44
Other	-4	--	-3	--	--	-7	--	--	--	--	--	35
Equals:												
Net income, returns with net income ..	980	1,121	1,196	1,317	1,336	1,463	2,279	3,325	6,206	23,832	22,349	29,278
Plus:												
Deficits, returns without net income .	-151	-189	-226	-141	-223	-284	-304	-303	-303	-252	-380	-437
Tax-exempt interest	2	4	3	4	3	4	4	3	2	4	4	3
Less: Foreign taxable income constructively received	--	12	1	1	7	3	1	2	3	2	17	34
Equals: Total receipts less total deductions	831	924	971	1,180	1,111	1,180	1,978	3,023	5,902	23,582	21,955	28,810
Bureau of Economic Analysis adjustments:												
Subtract:												
Foreign income included in total receipts less total deductions:												
Foreign dividends	8	1	8	9	9	10	8	8	13	14	19	
WHT deduction	5	1	1	2	1	2	3	3	1	8	9	
Other foreign income	681	902	904	1,043	1,068	1,202	1,845	2,897	5,567	22,646	20,595	
Domestic dividends received	22	22	21	23	23	20	62	45	53	66	69	
Gain, sale of assets	139	59	100	83	96	89	51	159	156	253	233	
Add: Domestic depletion	247	218	322	229	255	233	275	294	286	415	332	n.a.
Depreciation vs. Expense adjustment	39	28	28	21	35	26	11	39	44	144	275	
Oil well bonus payments	8	8	8	8	10	10	11	12	13	21	29	
State income tax	5	4	5	7	8	12	14	19	27	56	80	
Audit	27	28	30	37	52	48	45	46	49	55	74	
Other (net)	4	5	-4	6	-8	-31	-5	-30	-17	-8	-33	
Equals: Corporate profits - Current domestic production - National Income Product accounts	306	230	326	328	266	155	360	291	514	1,278	1,787	1,777

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May 2, 1979

p - Preliminary. n.a. - Not available.
Note: Details may not add to totals due to rounding.
Sources: Corporation Statistics of Income (IRS), and Bureau of Economic Analysis.

Appendix Table VI, continued
Nonoil Companies
(amounts in $ millions)

	1969 AMOUNT	1969 PCT.	1970 AMOUNT	1970 PCT.	1971 AMOUNT	1971 PCT.	1972 AMOUNT	1972 PCT.	1973 AMOUNT	1973 PCT.
ASSETS										
TOTAL	216990.156	1.00	238050.297	1.00	260006.105	1.00	280283.520	1.00	315533.937	1.00
ADJ. CURRENT	91013.682	.42	96661.350	.41	109156.725	.42	120210.956	.43	139637.738	.44
PLANT (NET)	99088.739	.46	109408.814	.46	116577.962	.45	123329.785	.44	135560.578	.43
INVESTMENTS	14027.739	.06	16164.098	.07	17760.677	.07	18695.288	.07	20733.397	.07
INTANGIBLES	5925.714	.03	7474.981	.03	8120.883	.03	8820.066	.03	9466.625	.03
ALL OTHER	6934.285	.03	8341.055	.04	8389.861	.03	9227.629	.03	10135.605	.03
LIABILITIES										
TOTAL	216990.156	1.00	238050.297	1.00	260006.105	1.00	280283.520	1.00	315533.937	1.00
ADJ. CURRENT	16388.261	.08	19797.297	.08	21630.807	.08	20526.821	.07	29380.314	.09
LN-TERM DEBT	44806.447	.21	51581.968	.22	57194.508	.22	61906.708	.22	66319.339	.21
DEFERRED TX.	4323.700	.02	5022.450	.02	5975.493	.02	6718.542	.02	8162.014	.03
NET WORTH	151471.750	.70	161648.584	.68	175205.299	.67	191131.449	.68	211672.273	.67

	1974 AMOUNT	1974 PCT.	1975 AMOUNT	1975 PCT.	1976 AMOUNT	1976 PCT.	1977 AMOUNT	1977 PCT.
ASSETS								
TOTAL	359325.840	1.00	381500.676	1.00	425550.680	1.00	469322.320	1.00
ADJ. CURRENT	162131.551	.45	168901.949	.44	195331.633	.46	212339.598	.45
PLANT (NET)	153780.918	.43	167146.443	.44	181567.088	.43	201262.932	.43
INVESTMENTS	22297.063	.06	23884.401	.06	26633.743	.06	30365.359	.06
INTANGIBLES	10491.415	.03	10249.244	.03	10246.001	.02	10979.915	.02
ALL OTHER	10624.895	.03	11318.645	.03	11772.219	.03	14374.523	.03
LIABILITIES								
TOTAL	359325.840	1.00	381500.676	1.00	425550.680	1.00	469322.320	1.00
ADJ. CURRENT	41127.946	.11	35942.015	.09	43752.717	.10	48405.676	.10
LN-TERM DEBT	77530.019	.22	84785.857	.22	87028.387	.20	93749.728	.20
DEFERRED TX.	9790.174	.03	11992.367	.03	14699.368	.03	16665.413	.04
NET WORTH	230877.703	.64	248780.437	.65	280070.211	.66	310501.808	.66

Corporations -- Petroleum (Extraction and Refining) Earnings and Net Federal Tax Liability
as Measured in the National Income and Product Accounts

($ millions)

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976p	1977p
	Calendar Years												
Corporate profits before tax:													
Petroleum and coal products	$2,843	3,197	3,820	3,623	3,324	3,657	3,597	3,606	5,505	10,773	8,293	11,704	12,944
Crude petroleum and natural gas extraction	306	230	326	328	266	155	360	291	514	1,278	1,787	1,777	2,137
Total	$3,149	3,427	4,146	3,951	3,590	3,812	3,957	3,897	6,019	12,051	10,080	13,481	15,081
Federal, state and local corporate profits tax liability:													
Petroleum and coal products	$405	679	684	620	519	746	727	754	1,282	2,518	2,517	3,939	4,306
Crude petroleum and natural gas extraction	74	53	47	76	67	84	101	126	194	405	492	588	761
Total	$479	732	731	696	586	830	828	880	1,476	2,923	3,009	4,527	5,067
State and local	$ 30	49	57	55	51	91	94	108	183	388	447	711	n.a.
Federal	$449	683	674	641	535	739	734	772	1,293	2,535	2,562	3,816	n.a.
Federal corporate profits tax liability as percent of profits less state and local income tax	14.4%	20.2	16.5	16.5	15.1	19.9	19.0	20.4	22.2	21.7	26.6	29.9	

Office of the Secretary of the Treasury, Office of Tax Analysis May 2, 1979

p - Preliminary
Note: Details may not add to totals due to rounding.
n.a. - Not available.
Source: Bureau of Economic Analysis.

Appendix Table VII-B

Corporations Classified in the Petroleum and Coal Products (Manufacturing) Industry
Reconciliation of Taxable Income Per Returns and Pretax Earnings Per National Income and Product Accounts

($ millions)

	Calendar Years											
	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976p
Corporation *Statistics of Income*:												
Income subject to tax	2,427	3,199	3,511	3,424	3,398	3,677	4,560	4,560	7,505	14,359	16,022	17,709
Plus:												
Net operating loss deduction	37	18	62	22	19	11	13	14	38	105	48	22
Dividends received deduction	424	513	551	629	507	822	932	1,255	2,856	5,053	231	2,265
WHT deduction	136	134	166	138	107	121	169	149		707	1,271	286
DISC and Subchapter S net income	3	2	10	1	6	6	12	10	9	19	11	17
Other	--	--	--	--	--	--	--	--	--	-61	--	-9
Equals:												
Net income, returns with net income ..	3,026	3,864	4,300	4,214	4,036	4,637	5,685	5,987	10,408	20,182	17,582	20,290
Plus:												
Deficits, returns without net income .	-37	-26	-20	-48	-87	-38	-57	-64	-47	-55	-75	-304
Tax-exempt interest	3	6	11	8	12	8	2	3	10	11	28	10
Less: Foreign taxable income constructively received	67	124	80	62	90	105	108	147	506	958	505	1,466
Equals: Total receipts less total deductions	2,925	3,719	4,212	4,111	3,870	4,502	5,522	5,779	9,865	19,180	17,029	18,531
Bureau of Economic Analysis adjustments:												
Subtract:												
Foreign income included in total receipts less total deductions:												
Foreign dividends	570	452	506	467	815	832	1,011	1,331	1,393	2,869	1,361	
WHT deduction	136	134	166	138	107	121	169	149	317	707	1,271	
Other foreign income	887	918	1,371	1,556	1,477	1,482	2,338	1,973	3,342	5,850	9,626	
Domestic dividends received	502	604	649	744	598	968	1,102	1,486	3,015	5,996	321	
Gain, sale of assets	122	490	209	212	328	187	162	394	170	251	974	n.a.
Add: Domestic depletion	1,415	1,501	1,774	1,899	1,865	1,760	2,022	2,097	2,622	4,670	768	
Depreciation vs. Expense adjustment	221	194	155	173	256	214	94	330	370	1,210	2,309	
Oil well bonus payments	252	260	258	265	316	307	336	350	434	678	952	
State income tax	25	45	52	48	43	79	80	89	156	332	367	
Audit	216	219	285	308	354	392	371	338	335	415	525	
Other (net)	6	-143	-33	-64	-55	-7	-45	-44	-40	-129	-104	
Equals: Corporate profits - Current domestic production - National Income Product accounts	2,843	3,197	3,820	3,623	3,324	3,657	3,597	3,606	5,505	10,773	8,293	11,7[illegible]

Office of the Secretary of the Treasury, Office of Tax Analysis — May 2, 1979

p - Preliminary. n.a. - Not available.
Note: Details may not add to totals due to rounding.
Sources: Corporation *Statistics of Income* (IRS), and Bureau of Economic Analysis.

Selected Rates of Return, Oil Companies and Others, 1969-1977

Item	1969	1970	1971	1972	1973	1974	1975	1976	1977
					(percent)				
Rate of return to equity:									
Oil and gas extraction	12.6	11.4	6.7	7.2	10.6	19.9	15.0	15.2	14.7
Integrated petroleum and refining	11.1	10.5	10.8	10.0	15.2	18.4	12.9	13.9	13.5
Others	12.4	10.3	11.3	12.9	14.4	13.0	12.0	14.4	14.8
Rate of return to assets employed:									
Oil and gas extraction	9.0	8.5	6.0	6.0	8.3	14.0	10.3	10.4	10.2
Integrated petroleum and refining	9.2	8.5	8.9	8.4	11.5	12.8	9.2	9.7	9.6
Others	10.0	8.9	9.5	10.5	11.2	10.6	10.2	11.2	11.5
Rate of return to market value of equity:									
Oil and gas extraction	4.6	6.2	2.9	3.0	4.9	11.7	9.9	8.5	9.1
Integrated petroleum and refining	6.9	9.0	8.4	7.4	11.2	18.4	13.4	13.0	12.7
Others	4.8	4.8	4.7	4.9	6.2	8.4	8.1	8.7	10.3

Office of the Secretary of the Treasury
Office of Tax Analysis

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Source: Standard and Poor's Corporation Compustat File.

Petroleum Refining and Integrated Companies 1/

Return on Stockholders' Equity as Measured in Financial Reports Filed with the Federal Trade Commission

Asset Size ($ millions)	Calendar Years				
	1974	1975	1976	1977	1978
Net Income After Tax* Per Dollar of Stockholders' Equity					
Under $5 million	33.5	17.9	12.6	24.6	16.0
5 under 10	31.0	45.0	28.2	34.1	33.7
10 under 25	41.9	33.3	32.6	13.3	17.2
25 under 50	23.7	16.4	30.9	22.0	16.8
50 under 100	35.8	24.7	18.7	26.7	15.5
100 under 250	15.5	11.9	14.4	17.6	16.2
250 under 1,000	28.5	14.7	16.2	15.2	16.8
1,000 and over	19.8	12.1	13.5	13.0	12.8
Total	20.0	12.3	13.6	13.2	13.0
Net Income Before Tax* Per Dollar of Stockholders' Equity					
Under $5 million	47.3	28.9	20.6	36.2	41.1
5 under 10	52.4	85.0	50.0	51.1	41.6
10 under 25	76.7	55.6	65.1	21.0	26.7
25 under 50	42.4	31.4	57.0	41.0	33.6
50 under 100	60.8	46.4	35.9	39.0	24.3
100 under 250	24.9	20.7	21.0	30.0	24.5
250 under 1,000	40.6	22.2	25.5	24.3	30.0
1,000 and over	23.9	17.1	19.2	18.8	19.0
Total	24.5	17.5	19.6	19.3	19.4

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Source: Federal Trade Commission, Quarterly Financial Report, (unpublished data).

*Excludes extraordinary gains or losses and minority stockholders' interest in income or loss of consolidated corporations.

1/ Excludes companies classified in the oil and gas extraction industry. Includes coal products. Classification is based on the Enterprise Standard Industrial Classification Manual.

Disposition of Net Increase in Oil Receipts
(Money Amounts in Billions of Dollars)

	Calendar Years				Total	Total
	1979	1980	1981	1982	1979-81	1979-82
Base Case--No Increase in Real OPEC Price						
Net increase in oil receipts	1.0	5.0	9.3	10.9	15.4	26.3
Net increase in after-tax producer and royalty income						
Without windfall profits tax	0.5	2.6	4.9	5.7	8.0	13.7
With windfall profits tax	0.5	2.1	3.4	3.9	6.0	9.9
Percent reduction due to windfall profits tax	-	18.4%	31.3%	30.8%	25.1%	27.4%
Gross windfall profits tax	-	0.8	2.5	2.8	3.2	6.0
Net windfall profits tax (after reduction in Federal income taxes)	-	0.5	1.5	1.7	2.0	3.8
Alternate Case--3 Percent Increase in Real OPEC Price						
Net increase in oil receipts	1.0	5.3	10.7	13.7	17.0	30.7
Net increase in after-tax producer and royalty income						
Without windfall profits tax	0.5	2.5	5.0	6.3	8.1	14.4
With windfall profits tax	0.5	1.9	2.9	3.5	5.4	8.8
Percent reduction due to windfall profits tax	-	23.5%	42.0%	45.4%	33.5%	38.7%
Gross windfall profits tax	-	1.0	3.4	4.7	4.3	9.0
Net windfall profits tax (after reduction in Federal income taxes)	-	0.6	2.1	2.9	2.7	5.6

Office of the Secretary of the Treasury, Office of Tax Analysis

May 3, 1979

Appendix Table XI
Sources and Uses of Funds, 1971-1977 Oil and Gas Extraction Companies
(amounts in $ millions)

	1969 AMOUNT	1969 PCT.	1970 AMOUNT	1970 PCT.	1971 AMOUNT	1971 PCT.	1972 AMOUNT	1972 PCT.	1973 AMOUNT	1973 PCT.
SOURCES										
ALL-SOURCES	.000	.00	.000	.00	1243.012	100.00	1550.229	100.00	2125.057	100.00
WORK CAP DEC	.000	.00	.000	.00	48.888	3.93	.000	.00	.000	.00
OPERATIONS	.000	.00	.000	.00	807.679	64.98	845.006	54.51	1211.243	57.00
NET-INCOME	.000	.00	.000	.00	300.358	24.16	361.418	23.31	583.959	27.48
CAP-CONSUMP.	.000	.00	.000	.00	482.533	38.82	528.413	34.09	669.589	31.51
DEFERRED TAX	.000	.00	.000	.00	18.137	1.46	12.957	.84	26.284	1.24
OTHER-OPER.	.000	.00	.000	.00	6.651	.54	-57.782	-3.73	-68.589	-3.23
ISSUES-LTD	.000	.00	.000	.00	66.234	5.33	435.980	28.12	78.792	3.71
ISSUES-STOCK	.000	.00	.000	.00	51.985	4.18	108.602	7.01	265.228	12.48
ALL-OTHER	.000	.00	.000	.00	268.226	21.58	160.641	10.36	569.794	26.81
USES										
ALL-USES	.000	.00	.000	.00	1243.012	100.00	1550.229	100.00	2125.057	100.00
WORK CAP INC	.000	.00	.000	.00	.000	.00	128.670	8.30	148.971	7.01
DIVIDENDS	.000	.00	.000	.00	164.150	13.21	120.266	7.76	127.808	6.01
CAP-EXPEND.	.000	.00	.000	.00	821.276	66.07	1072.301	69.17	1517.080	71.39
INVESTMENTS	.000	.00	.000	.00	58.959	4.74	48.388	3.12	33.300	1.57
ALL-OTHER	.000	.00	.000	.00	198.627	15.98	180.606	11.65	297.898	14.02

	1974 AMOUNT	1974 PCT.	1975 AMOUNT	1975 PCT.	1976 AMOUNT	1976 PCT.	1977 AMOUNT	1977 PCT.
SOURCES								
ALL-SOURCES	2724.600	100.00	3202.200	100.00	3537.440	100.00	4511.467	100.00
WORK CAP DEC	.000	.00	.000	.00	.000	.00	.000	.00
OPERATIONS	2107.094	77.34	2069.586	64.63	2363.517	66.81	3099.483	68.70
NET-INCOME	1202.733	44.14	1022.208	31.92	1171.317	33.11	1427.552	31.64
CAP-CONSUMP.	755.923	27.74	883.262	27.58	975.473	27.58	1228.422	27.23
DEFERRED TAX	29.430	1.08	167.490	5.23	172.113	4.87	453.445	10.05
OTHER-OPER.	119.006	4.37	-3.374	-.11	44.614	1.26	-9.936	-.22
ISSUES-LTD	179.187	6.58	288.380	9.01	707.344	20.00	332.262	7.36
ISSUES-STOCK	20.791	.76	196.438	6.13	108.151	3.06	697.013	15.45
ALL-OTHER	417.528	15.32	647.796	20.23	358.428	10.13	382.709	8.48
USES								
ALL-USES	2724.600	100.00	3202.200	100.00	3537.440	100.00	4511.467	100.00
WORK CAP INC	245.548	9.01	250.738	7.83	54.083	1.53	40.674	.90
DIVIDENDS	165.367	6.07	257.446	8.04	279.223	7.89	361.701	8.02
CAP-EXPEND.	1942.473	71.29	2377.492	74.25	2605.673	73.66	3338.195	73.99
INVESTMENTS	22.942	.84	-43.968	-1.37	168.551	4.76	45.879	1.02
ALL-OTHER	348.270	12.78	360.492	11.26	429.910	12.15	725.018	16.07

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

May 14, 1979

TEXT OF CLAIMS/ASSETS AGREEMENT BETWEEN THE UNITED STATES AND THE PEOPLE'S REPUBLIC OF CHINA

AGREEMENT BETWEEN THE GOVERNMENT
OF
THE UNITED STATES OF AMERICA
AND THE GOVERNMENT OF
THE PEOPLE'S REPUBLIC OF CHINA
CONCERNING THE SETTLEMENT OF CLAIMS

In order to develop bilateral economic and trade relations and to complete the process of normalization of relations on the basis of equality and mutual benefit and in accordance with the spirit of the Joint Communique on Establishment of Diplomatic Relations between the United States of America and the People's Republic of China, the Government of the United States of America (hereinafter referred to as the "USA") and the Government of the People's Republic of China (hereinafter referred to as the "PRC") have reached this Agreement:

ARTICLE I

The claims settled pursuant to this Agreement are:

(a) the claims of the USA and its nationals (including natural and juridical persons) against the PRC arising from any nationalization, expropriation, intervention, and other taking of, or special measures directed against, property of nationals of the USA on or after October 1, 1949 and prior to the date of this Agreement; and

(b) the claims of the PRC, its nationals, and natural and juridical persons subject to its jurisdiction or control against the USA arising from actions related to the blocking of assets by the Government of the USA on or after December 17, 1950 and prior to the date of this Agreement.

ARTICLE II

(a) The Government of the USA and the Government of the PRC agree to a settlement of all claims specified in Article I. The Government of the PRC agrees to pay to the Government of the USA the sum of $80.5 million as the full and final settlement of the claims specified in Article I. The Government of the USA agrees to accept this sum in full and final settlement of those claims.

(b) The Government of the USA agrees to unblock by October 1, 1979 all assets which were blocked because of an interest, direct or indirect, in those assets of the PRC, its nationals, or natural and juridical persons subject to its jurisdiction or control, and which remained blocked on the date of the initialing of this Agreement, March 2, 1979. The Government of the USA further agrees, in a spirit of mutual cooperation, that prior to unblocking under this paragraph, it will notify the holders of blocked assets which the records of the Government of the USA indicate are held in the name of residents of the PRC that the Government of the PRC requests that assets of nationals of the PRC to be unblocked not be transferred or withdrawn without its consent.

ARTICLE III

The Government of the PRC shall pay to the Government of the USA, $80.5 million of which $30 million shall be paid on October 1, 1979 and the remaining $50.5 million shall be paid in five annual installments of $10.1 million each on the first day of October with the first installment due on October 1, 1980.

ARTICLE IV

The Government of the USA shall be exclusively responsible for the distribution of all proceeds received by it under this Agreement.

ARTICLE V

After the date of signature of this Agreement, neither government will present to the other, on its behalf or on behalf of another, any claim encompassed by this Agreement. If any such claim is presented directly by a national of one country to the government of the other, that government will refer it to the government of the national who presented the claim.

ARTICLE VI

This Agreement shall enter into force on the date of signature.

The Agreement was signed on May 11, 1979 at Beijing, in duplicate, in the English and Chinese languages, both versions being equally authentic.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA	FOR THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA
/s/ Juanita M. Kreps	/s/ Zhang Jingfu

Appendix Table XI, continued
Integrated Petroleum and Refining Companies
(amounts in $ millions)

	1969 AMOUNT	1969 PCT.	1970 AMOUNT	1970 PCT.	1971 AMOUNT	1971 PCT.	1972 AMOUNT	1972 PCT.	1973 AMOUNT	1973 PCT.
SOURCES										
ALL-SOURCES	.000	.00	.000	.00	17134.395	100.00	17109.423	100.00	23186.472	100.00
WORK CAP DEC	.000	.00	.000	.00	.000	.00	.000	.00	.000	.00
OPERATIONS	.000	.00	.000	.00	13289.654	77.56	13579.636	79.37	18563.079	80.06
NET-INCOME	.000	.00	.000	.00	7122.707	41.57	7046.247	41.18	11435.064	49.32
CAP-CONSUMP.	.000	.00	.000	.00	6100.965	35.61	6462.461	37.77	7291.261	31.45
DEFERRED TAX	.000	.00	.000	.00	344.051	2.01	425.170	2.49	801.303	3.46
OTHER-OPER.	.000	.00	.000	.00	-278.069	-1.62	-354.242	-2.07	-964.549	-4.16
ISSUES-LTD	.000	.00	.000	.00	2350.358	13.72	997.901	5.83	473.244	2.04
ISSUES-STOCK	.000	.00	.000	.00	-16.280	-.10	150.133	.88	-549.171	-2.37
ALL-OTHER	.000	.00	.000	.00	1510.663	8.82	2381.753	13.92	4699.320	20.27
USES										
ALL-USES	.000	.00	.000	.00	17134.395	100.00	17109.423	100.00	23186.472	100.00
WORK CAP INC	.000	.00	.000	.00	999.582	5.83	582.758	3.41	4628.146	19.96
DIVIDENDS	.000	.00	.000	.00	3719.965	21.71	3732.914	21.82	3985.420	17.19
CAP-EXPEND.	.000	.00	.000	.00	10952.937	63.92	10932.685	63.90	11889.952	51.28
INVESTMENTS	.000	.00	.000	.00	883.200	5.15	846.097	4.95	574.413	2.48
ALL-OTHER	.000	.00	.000	.00	578.711	3.38	1014.969	5.93	2108.541	9.09

	1974 AMOUNT	1974 PCT.	1975 AMOUNT	1975 PCT.	1976 AMOUNT	1976 PCT.	1977 AMOUNT	1977 PCT.
SOURCES								
ALL-SOURCES	36343.181	100.00	28909.307	100.00	33449.211	100.00	33915.560	100.00
WORK CAP DEC	.000	.00	816.766	2.83	.000	.00	.000	.00
OPERATIONS	25227.447	69.41	18613.509	64.39	23213.020	69.40	26723.927	78.80
NET-INCOME	15937.205	43.85	11423.845	39.52	13380.961	40.00	14275.446	42.09
CAP-CONSUMP.	8501.720	23.39	9504.638	32.88	9539.025	28.52	10973.316	32.35
DEFERRED TAX	1102.513	3.03	1118.999	3.87	1721.630	5.15	2153.536	6.35
OTHER-OPER.	-313.991	-.86	-3433.973	-11.88	-1428.596	-4.27	-678.371	-2.00
ISSUES-LTD	2896.531	7.97	5017.344	17.36	5611.574	16.78	3351.518	9.88
ISSUES-STOCK	288.163	.79	293.639	1.02	677.568	2.03	605.932	1.79
ALL-OTHER	7931.041	21.82	4168.049	14.42	3947.050	11.80	3234.183	9.54
USES								
ALL-USES	36343.181	100.00	28909.307	100.00	33449.211	100.00	33915.560	100.00
WORK CAP INC	5747.777	15.82	.000	.00	2455.451	7.34	752.606	2.22
DIVIDENDS	4598.512	12.65	4843.326	16.75	5151.210	15.40	5815.242	17.15
CAP-EXPEND.	19420.103	53.44	20949.962	72.47	22351.207	66.82	24552.899	72.39
INVESTMENTS	2611.035	7.18	1437.932	4.97	827.364	2.47	626.463	1.85
ALL-OTHER	3965.754	10.91	1678.087	5.80	2663.979	7.96	2168.349	6.39

Summary of Additional Oil Receipts and Taxes under Decontrol and the Windfall Profits Tax

Assuming No OPEC Real Increase in Prices

($ millions)

	Calendar Years						
	1979	1980	1981	1982	1983	1984	1985
Decontrol:							
Gross increase in oil receipts	1,208	5,797	11,503	14,488	15,119	17,657	20,375
Less deductible costs of induced production	-167	-751	-2,170	-3,625	-4,687	-7,366	-10,156
Net increase in oil receipts	1,041	5,046	9,333	10,863	10,432	10,291	10,219
Less depletion and state and local severences and income taxes	-134	-644	-1,158	-1,308	-1,218	-1,184	-1,176
Increase in federal taxable income	907	4,402	8,175	9,555	9,214	9,107	9,043
Federal marginal income tax rate	.45	.45	.45	.45	.45	.45	.45
Increase in federal income tax before windfall profits tax	408	1,981	3,679	4,300	4,146	4,098	4,070
Windfall profits tax:							
Gross windfall profits tax	--	766	2,457	2,815	2,022	1,752	1,510
Net change in federal taxable income	--	-638	-2,062	-2,384	-1,729	-1,502	-1,296
Federal marginal income tax rate	.45	.45	.45	.45	.45	.45	.45
Reduction in federal income tax for windfall profits tax	--	-287	-928	-1,073	-778	-676	-583
Disposition of net increase in oil receipts:							
Private sector	520	2,116	3,357	3,922	4,110	4,176	4,266
State and local government	92	369	583	682	721	735	752
Federal Government (includes federal royalties)	429	2,561	5,393	6,259	5,601	5,380	5,201
Total net increase	1,041	5,046	9,333	10,863	10,432	10,291	10,219
Addenda:							
Effective federal tax rate:							
On gross increase in oil receipts	.34	.42	.45	.42	.36	.29	.25
On net increase in oil receipts	.39	.49	.56	.56	.52	.50	.49
Effective federal income tax rate before windfall profits tax:							
On gross increase in oil receipts	.34	.34	.32	.30	.27	.23	.20
On net increase in oil receipts	.39	.39	.39	.40	.40	.40	.40

Office of the Secretary of the Treasury
Office of Tax Analysis

April 27, 1979

GPO 941 546

Selected Purchases by Petroleum Companies of Businesses Not Clearly
Identified as Petrochemical or Other Energy
Examples

Purchasing company	Purchased company	Date	Selected Details
8. Ashland	Polk Material	1971	20,000 common shares
	Angelo Tomasso	1971	520,000 shares
	Mac's Super Glass	1972	63,024 common shares
	Harrison Incorporated	1972*	
	Franklin Stone	1972*	132,089 common shares
	Star Construction	1972*	
	*asphalt paving		
	Reno Construction	1972	320,000 common shares
	Mac's Super Glass (auto polishes and related products)	1972	63,024 common shares
	Seaboard Construction	1973	65,000 common shares
	Levingston Ship Building Company	1975	Exchange of shares; 802,632 were issued
	Hodges & Company	1976	38,500 shares
	Nielsons	1977	565,000 common shares
9. Tesoro	Arnold Pipe Rental	1970	104,530 shares and $212,000 payable in stock and cash
	Charles Wheatly Company (producer of petroleum valves)	1972	220,000 shares
	VFI Incorporated	1973	
	Eagle Transport Company	1974	40,000 common shares
	Turner Drill Pipe	1974	Cash and provisionary note = $700 million
10. Pennzoil	W. S. Ranch	1973	
			Pending
11. Mobil	Badcow (forest products, liner board, oil & gas)		Preferred stock of $475 million (represents a portion of authorized but not issued stock)
12. Sun	1. Metrodata Computing (INCs computing div.)		$3 million -- Merger, amount undisclosed
13. Occidental Corporation	Meade Corporation		
14. Standard Oil (Indiana)	Cypress Mines		

Source: Moody's and Annual Reports.

reporting worldwide sales of integrated petroleum and refining companies show that over 96 percent of the sales were accounted for by 28 companies, 1.7 percent of the total. This dominance of the largest firms is also reflected in FTC data pertaining only to domestic sales: nearly 93 percent of total sales was reported by the largest firms, those with assets over $250 million.

Similarly, because capital intensity in the oil business is extremely high, corporations are by far the most dominant form of business organization. In 1976, the most recent tax year available, among enterprises engaged in oil and gas extraction and refining corporations accounted for over 98 percent of sales, but only 13 percent of the enterprises in the industry.

U.S. Oil Extraction and Refining Enterprises

	1973	1974	1975	1976
		($ million)		
Worldwide sales:	141,696	309,263	308,558	361,351
Percentage by:				
Corporations	98.1	98.5	98.2	98.2
Proprietorships	1.1	0.8	0.9	0.9
Partnerships	0.8	0.7	0.9	1.0

Source: Appendix Table III.

Due to the historical precedence of the U.S. oil industry, it has been a dominant force in world trade. When rich oil discoveries abroad burgeoned during the preceding 35 years, U.S. companies were among the most successful developers of productive capacity. As a consequence, the income of U.S. oil companies is predominantly foreign. In 1976, nearly 80 percent of all oil company corporate income subject to tax derived from foreign operations. However, there is some indication that the widespread recourse to expropriation policies abroad has caused some decline in the relative importance of foreign operations of U.S. companies.

Foreign and Domestic Taxable Income; All Oil Company Tax Returns

	1972		1975		1976	
	Amount	Percent	Amount	Percent	Amount	Percent
	(. . . . . ($ million) . . . .)					
Worldwide taxable income:	7,781	100.0	38,146	100.0	46,643	100.0
Foreign operations	6,760	86.9	31,791	83.3	36,450	78.2
Domestic operations	1,021	13.1	6,355	16.7	10,193	21.9

Source: Appendix Table IV.

As a final perspective on the oil industry, I would like to review its financial structure. For this purpose, I shall utilize data from the Compustat file of financial reports maintained by Standard and Poor's and also financial survey data published by the Federal Trade Commission. The Compustat file covers more than 3,000 publicly held corporations, and records data from their financial statements. The FTC survey directly collects financial information from a sample of nonfinancial corporations; in contrast with Compustat and other compilations of financial statistics, the FTC data are requested in a format designed to isolate foreign operations. With respect to the oil companies each includes in its coverage, the balance sheet and income statement items are not fully comparable with those reported by other manufacturing corporations. The asset and income accounting conventions used by oil companies more frequently permit current deduction of investment outlays for establishing the existence of oil and gas reserves, a significant and valuable asset. This results in a relative understatement of income whenever such outlays are increasing and in an undervaluation of the reserves and net worth. However, these accounting conventions are less frequently used by smaller independent companies engaged primarily in extraction.

In 1977 the Compustat data indicate that oil extraction companies had 75 percent of their total assets in fixed plant, integrated and refining companies 65 percent, and nonoil companies only 43 percent. This mildly understates the heavy reliance of oil companies on fixed plant. Other companies devote more of their assets to working capital -- cash and inventories -- and this provides them a higher average turnover rate. Because the FTC data are especially consolidated to focus on domestic operations, the balance sheet elements based on reports to the FTC (Appendix Table V) do not usefully portray the composition of assets employed: the value of plant, equipment, and working capital in foreign operations is subsumed under "other assets" in the form of interests in those enterprises.

Fixed Assets As Percentage of Total Assets

Industry	1971	1972	1973	1974	1975	1976	1977
Oil and gas extraction	69	69	69	70	71	72	75
Integrated petroleum and refining	70	70	66	61	62	63	65
All other manufacturing	45	44	43	43	44	43	43

Source: Appendix Table VI.

Notwithstanding the oil companies' greater reliance on fixed assets, the method by which they finance their total assets does not markedly differ from other large companies. For example, in 1977 oil extraction and integrated refining companies financed 63 and 61 percent of their assets by equity, respectively, as compared with 66 percent for other manufacturing corporations. Although the equity percentage of other manufacturing has held fairly steady over the period 1971-77, the equity percentage of oil companies appears to decline, suggesting a greater reliance on debt.

Both the slightly lower oil company equity percentages and the indicated declines therein are influenced by the accounting conventions noted above. In the period since 1972, when oil prices have been rising, many of the oil companies' real assets have been appreciating. Thus, as

Equity (Net Worth) as Percentage of Total Assets

Industry	1971	1972	1973	1974	1975	1976	1977
Oil and gas extraction	69	66	67	65	64	63	63
Integrated petroleum and refining	71	71	71	67	64	61	61
All other manufacturing	67	68	67	64	65	66	66

Source: Appendix Table VI.

large volumes of resource replacement expenditure have been made, more of these additions to total assets have been financeable by borrowing on the enhanced, but financially unrecorded, value of oil company reserves.

These comparative statistics are consistent with the FTC data, after allowance for the differences in definition of total assets. Whereas we have "netted out" trade credit in compiling Compustat data, the FTC data include the total of accounts and short-term notes receivable among the assets, and total accounts and short-term notes payable among the liabilities. As compared with the foregoing Compustat percentages, both the oil companies' and others' figures are lower, the latter by more because of the greater importance of trade credit in their operations but the downward trend of the oil companies' equity percentage still appears while the other companies' percentages hold steady.

Equity (Net Worth) as Percentage of Total Assets

Industry	1974	1975	1976	1977	1978
Integrated petroleum and refining	63	62	60	59	57
Other manufacturing	51	52	53	52	51

Source: Appendix Tables V-A and V-B.

A final descriptor of the financial structure of corporations is the ratio of long-term debt to equity. Given the near equivalence of oil and nonoil company equity percentages and the fact that nonoil companies rely more on trade credit, it follows that oil companies will exhibit slightly higher long-term debt to equity ratios. Thus, in 1977 when oil extraction and integrated refining companies had long-term debt outstanding equal to 36 and 35 percent of their equity, respectively, other manufacturing firms had a ratio of but 30 percent.

Long-term Debt as Percentage of Equity

Industry	1971	1972	1973	1974	1975	1976	1977
Oil and gas extraction	35	39	36	35	35	38	36
Integrated petroleum and refining	28	28	26	25	31	34	35
Other manufacturing	33	32	31	34	34	31	30

Source: Appendix Table VI.

Profitability

I should like to make four general observations before reviewing the information on oil company profitability we have been able to assemble. First, profits have a complex relationship to changes in the price of output. When output prices, crude oil prices in the present instance, rise, profits also immediately rise. However, the extent to which higher profits can be maintained depends upon the behavior of costs. Real unit costs rise as greater effort is expended on pumping oil from existing fields and as less attractive prospects are drilled. Until costs rise to fully match increases in output prices and thus to restore profits to normal levels, higher levels of profits will prevail.

Second, profits are an aggregate, like a wages bill or costs of materials. For an enterprise as for a collection of them, as activity expands and efforts are made to increase capacity, the capital aggregate to which the profits are attributable also grows. It is one thing to observe that a wages bill has doubled while the number of person-hours expended has remained the same; it is another to observe that wages have doubled simply because twice as many person-hours are employed. Similarly, profits may be evaluated only if they are compared to an appropriate base. Profit per dollar of equity capital is one such measure.

Third, profits are but one share of the income generated by the capital employed by an enterprise. As we have noted, about a third of oil company assets are financed by creditors. If we are to examine the vitality of an industry, we must consider the net return earned by all the assets, the sum of interest to creditors and profits to shareholders.

Finally, prices and sales revenues are all pretax magnitudes. But it is commonly accepted that individuals making market decisions are driven by after-tax magnitudes. Consumers may spend only what remains to them from their earnings after tax; and the funds to acquire capital assets are also what creditors and shareholders have left from their earnings from all sources after tax. At the corporate level, then, what is of interest in discussing profitability is what remains from the corporation's product after all costs and corporation taxes, when this residual magnitude is expressed as a rate of return to equity or to total assets employed.

"Profits" of corporations are a residual obtained by subtracting from the amount of receipts (sales plus returns on securities held) the cost of goods sold, interest paid creditors, and an allowance for capital consumption. Thus, there is no unambiguous measure of "profit." While receipts are measurable with little controversy, measurement of the cost of goods sold in a period of inflation is both difficult and controversial, and for oil companies, whether certain outlays for reserve discovery and development should be treated as current period costs of goods sold or capitalized is a further controversial and unresolved issue, as is then the allowance for capital consumption.

To illustrate the great variance in measures of oil company profits, in 1976, the taxable income of oil companies was $46.6 billion; for that same year, the Department of Commerce estimated pretax corporate profits for the same companies at $13.5 billion. By far the biggest source of difference between these two measures is due to scope: taxable income is worldwide, National Income and Products Account profits by industry are restricted to domestic production. The other large source of difference arises from differences between tax rules for treating outlays for depreciable and depletable property and for income excluded by the Code, such as tax-exempt interest and percentage depletion. Thus, over the period from 1971 to 1976, income (profits) subject to tax increased by a factor of 7, National Income profits by a factor slightly greater than 3.

Pretax Profits of U.S. Oil Companies

	1971	1972	1973	1974	1975	1976
	(.		$ billion	. . . .		.)
Worldwide income subject to tax	6.7	7.8	13.5	37.9	38.1	46.6
Corporation profits, domestic, National Income and Product Accounts basis	4.0	3.9	6.0	12.1	10.1	13.5

Source: Appendix Tables VII-A,VII-B.

If one accepts the National Income Accounts estimate of oil company profits, then these may be compared with the estimate of associated Federal income tax from the same source. In 1976, after payment of State and local income taxes, $12.8 billion of oil company domestic income generated $3.8 billion in Federal tax liability, an average tax rate of 29.9 percent. It will be observed that in 1975 and 1976, the average rate of tax estimated by the Commerce Department has increased, from 21.7 percent in 1974 to 26.6 percent in 1975. This reflects, of course, the repeal of percentage depletion for oil and gas with respect to the integrated oil companies.

Corporations in the Petroleum Sector

	1971	1972	1973	1974	1975	1976
			($ billion)			
Corporate profits before Federal income tax,* National Income and Products Account basis	3.9	3.8	5.8	11.7	9.6	12.8
Federal income tax liability	0.7	0.8	1.3	2.5	2.6	3.8
Average tax rate on National Income and Products Account profit (percent)	19.0	20.4	22.2	21.7	26.6	29.9

*Corporate profits after State and local income taxes.

Source: Appendix Table VIII.

Unfortunately, the National Income and Products Accounts estimates of oil company profits and Federal income taxes cannot be used to derive a useful measure of profitability. There is no corresponding balance sheet to provide a measure of the capital employed in the industry nor to indicate how the claims against this capital are distributed as between creditors and shareholders. For measures of the profit rate, then, we must turn to financial statements, keeping in mind the inherent weaknesses of the measures of pretax income and the balance sheet valuation of assets and net worth.

The indications here are that in 1977, while all nonoil companies in the Compustat file earned an after-tax rate of return of 14.8 percent, oil extraction companies earned slightly less, 14.7 percent, and integrated oil and refining companies still less, 13.5 percent. During the period 1971-77, while nonoil companies were increasing their rates of return by 3.5 percentage points, or 31 percent, extraction companies increased their extremely low 1971 rate of return by 119 percent, and integrated companies increased their return by 25 percent. In 1974, as a result of the higher prices on crude oil, the oil companies did achieve higher than normal rates of return, approximating 20 percent. However, rising costs caused these profit rates to recede. The FTC data, closely track the Compustat returns despite the difference in industry coverage.

Rates of Return to Equity (After-tax)

Industry	1971	1972	1973	1974	1975	1976	1977
				(percent)			
Compustat:							
Oil and gas extraction	6.7	7.2	10.6	19.9	15.0	15.2	14.7
Integrated petroleum and refining	10.8	10.0	15.2	18.4	12.9	13.9	13.5
Other manufacturing	11.3	12.9	14.4	13.0	12.0	14.4	14.8
FTC:							
Integrated petroleum and refining		N.A.		20.0	12.3	13.6	13.2
Other manufacturing		N.A.		13.2	11.1	13.6	13.9

Sources: Appendix Tables V-A, V-B, X.

If we combine interest paid and after-tax profits of stockholders as a measure of the earnings of assets employed in the oil business, their ratio to the total amount of assets employed is another indicator of industry profitability. These percentages tell essentially the same story as rates of return to equity. In 1977, returns to oil company assets were slightly below nonoil manufacturing corporations in the Compustat file. These latter firms averaged a return of 11.5 percent on total assets employed while oil extraction companies earned 10.2 percent and integrated oil and refinery companies earned 9.6 percent. These indicators also show that oil company earnings were relatively unfavorable in pre-1973 years and that 1974 was an extremely profitable year.

Rates of Return on Assets Employed

Industry	1971	1972	1973	1974	1975	1976	1977
				(percent)			
Oil and gas extraction	6.0	6.0	8.3	14.0	10.3	10.4	10.2
Integrated petroleum and refining	8.9	8.4	11.5	12.8	9.2	9.7	9.6
Other manufacturing	9.5	10.5	11.2	10.6	10.2	11.2	11.5

Source: Appendix Table X.

Finally, I would call your attention to Appendix Table IX which the FTC has kindly furnished us. This presents a distribution of rates of return to equity for integrated oil and refinery companies by size of total assets for each year 1974-78. There is no clear relationship between size of company and rate of return except that in each year the very largest size class has earned a below average rate of return. This result is consistent with similar analyses we have made of tax return data; it may either indicate that the largest firms are less efficient, or it may indicate that the largest firms, because they enjoy stability of earnings, can raise funds at lower cost.

Financing the Changes in Capital Employed by Oil Companies

We have been requested to provide an analysis of oil company finances in recent years to include both the three major sources of funds -- cash flow from operations, new borrowing, and new issues of shares -- as well as the application of these funds to distributions to shareholders, outlays for plant and equipment, and investments in the securities of other enterprises. For such data, the only source readily accessible to us is the Compustat file which provides conveniently formatted sources and uses of funds statements beginning with the year 1971. These data, classified by industry as above, are presented in Appendix Table XI.

Sources of Funds

Cash Flow. Like any group of long-established firms, oil companies engaged primarily in extraction as well as integrated firms rely heavily on operations for the bulk of their disposable funds. After reducing the net realizations from sales of goods and services for production expenses, net payments of interest, and taxes, the remainder, commonly called "cash flow" accounted in 1977 for 69 and 81 percent of all sources of funds for oil companies as compared with 87 percent for all manufacturing companies. As shown in Appendix Table XI, total sources of funds include external financing and reductions of working capital (cash, inventories, and net receivables) as well as cash flow from operations.

Cash Flow

	1971	1972	1973	1974	1975	1976	1977
	(percent of total sources)						
Oil and gas extraction	64	58	60	73	65	66	69
Integrated petroleum and refining	79	81	84	70	76	74	81
Other manufacturing	77	83	85	74	78	85	87

Source: Appendix Table XI.

In principle, cash flow consists of two elements: the after-tax income which might be distributed to shareholders and leave the corporation's earning capacity unchanged, and the amount of capital consumed which, if not replaced by new capital outlays, would impair the earning capacity of the corporation. As a practical matter, standard accounting procedures for estimating depreciation and depletion provide no reliable measure of capital consumption, particularly in the oil industry which is characterized by relatively long physical lives of plant and equipment and where the principal assets -- oil and gas reserves -- defy conventional accounting valuation. Given the long lives of refineries and pipelines, they are particularly susceptible to technical and market-shift obsolescence, exacerbated in the last 15 years by the rapid evolution of environmental regulations that have affected both the nature of refinery products demanded and the processing techniques required. Moreover, the persistence of inflation over the same period has cast further doubt on standard accounting measures of depreciation and depletion because these rely on historic costs. Thus, although the total cash flow from current operations, which is measured in current year dollars, is a reliable figure, its allocation between net income of corporate equity and capital consumption is questionable.

Two further complexities arise in evaluating cash flow because it is reported net of income tax. First, unlike the accounting for sales and expense transactions that underlie the measurement of pretax income, the accounting for tax-related transactions is not uniformly on an accrual basis. For example, the income tax account is used to clear tax refunds pertaining to prior year losses. When this occurs, the "refund" is reported as an addition to current year net income; this "inflates" net (after-tax) income in the year the "refund" is received while causing an overstatement of the loss in the year it was experienced. Similarly, the income tax account is used to clear payment of the investment credit, and this may be accounted for under existing accounting principles as a reduction in tax and, hence, an increase in after-tax income even though the tax subsidy has little to do with income-earning operations of the year in question.

Second, under the tax laws, recovery of depreciable and depletable capital outlays is commonly more accelerated than the comparable capital consumption allowances estimated for financial reporting purposes. For oil companies, tax depreciation allowances tend to be computed by more accelerated methods than are used for financial reporting; and drilling costs are more rapidly written-off for tax than for financial reporting purposes. When this occurs, taxable income generated by the company's operations is deferred to later years as compared with the pretax income reported by the corporation for a given year. By the same token, tax liability for a given year is deferred. Under accepted accounting principles, this condition is reported under the heading "deferred taxes"; and although this source of funds is in the nature of an interest-free loan, it is conventionally reported as a component of cash flow arising from operations. With these qualifications, the reported composition of cash flow for oil companies is:

Composition of Cash Flow

	1971	1972	1973	1974	1975	1976	1977
	(. . . . . percent of cash flow . . . .)						
Net income:							
Oil and gas extraction	38	40	46	60	49	51	46
Integrated petroleum and refining	52	51	59	62	52	54	52
Other manufacturing	53	56	59	56	54	59	60
Capital consumption:							
Oil and gas extraction	60	59	52	38	43	52	40
Integrated petroleum and refining	45	46	37	33	43	39	40
Other manufacturing	45	42	39	40	42	37	37
Deferred taxes:							
Oil and gas extraction	2	1	2	2	8	7	14
Integrated petroleum and refining	3	3	4	4	5	7	8
Other manufacturing	2	2	2	4	4	4	3

Source: Appendix Table XI.

The notable distinctions of oil company cash flow as compared with nonoil companies are these: (a) except in 1974, net income is a smaller contribution to oil company cash flow; (b) correspondingly, capital consumption allowances tend to be relatively more important; and (c) most notably, deferred taxes have become increasingly important. The implication of this latter fact is that tax-preferred capital outlays by oil companies, have been rising since 1974, particularly among oil extraction companies.

<u>External Financing</u>. In addition to cash flow, funds may be obtained by the issuance of securities. Cash flow is commonly called "internal financing"; funds obtained by net new borrowing and issuance of stock is called "external financing."

External Sources of Funds

Source/Industry	1971	1972	1973	1974	1975	1976	1977
	(. . . . . percent of total sources . . . . .)						
Long-term debt:							
Oil and gas extraction	6	28	4	7	9	20	7
Integrated petroleum and refining	14	6	2	8	18	17	10
Other manufacturing	5	3	0	16	11	2	5
New stock:							
Oil and gas extraction	4	7	12	1	6	3	15
Integrated petroleum and refining	0	1	(2)*	1	1	2	2
Other manufacturing	9	9	9	2	4	4	0

* Net reduction in stock outstanding.

Source: Appendix Table XI.

Altogether, external financing accounted for 22 percent of oil extraction company funds in 1977, 12 percent of integrated oil and refining company funds, and but 5 percent of nonoil company funds. The wide annual variation in percentages of funds derived from external sources results from the compounding effect of some variation in the amounts of securities issued each year and the larger variation in cash flow. In this respect, the oil companies seem to behave no differently than nonoil companies. There is no evidence that oil companies are somehow more reliant on cash flow than companies in other industries.

Uses of Funds

Dividends. An essential application of corporate funds is the payment of dividends to stockholders. Whatever may be the precise financial policy of a large corporation regarding its retention of after-tax income, it must sustain some level of pay-out to stockholders by way of providing them assurance that their real incomes are being preserved, or enhanced, by management's stewardship. As the following dividend data show, integrated oil companies behave very much like nonoil companies: dividend payouts are a relatively stable fraction of total sources of funds, but a variable fraction of reported net income. Oil extraction companies follow a similar policy, but they pay out much smaller fractions of net income and total sources.

It is worth noting that each of the three categories tends to pay out a declining fraction of reported net income, thereby manifesting a justifiable doubt about the "quality" of reported earnings. Similarly it is notable that in 1973-74, when both classes of oil companies experienced sharp boosts in net earnings, payout fractions dropped dramatically.

Stockholder Distributions

Item	1971	1972	1973	1974	1975	1976	1977
	(. . . . . dollar amounts in billions . . . .)						
Oil and gas extraction							
Dividends paid	$0.2	$0.1	$0.1	$0.2	$0.3	$0.3	$0.4
Percent of:							
Net income	55	36	22	14	25	24	25
All sources	13	8	6	6	8	8	8
Integrated petroleum and refining							
Dividends paid	$3.7	$3.7	$4.0	$4.6	$4.8	$5.2	$5.8
Percent of:							
Net income	52	53	35	29	42	38	41
All sources	22	22	17	13	17	15	17
Other manufacturing							
Dividends paid	$8.9	$9.5	$10.4	$11.1	$11.3	$13.7	$16.6
Percent of:							
Net income	50	43	38	40	41	37	40
All sources	25	25	22	20	21	23	23

Source: Appendix Table XI.

Capital Outlays. But by far the most important use of funds is for capital outlays. These outlays not only cover replacement of capital consumed -- oil and gas productive capacity exhausted by production and obsolescent and worn-out plant and equipment -- but also any net additions to productive capacity that appear to be economically justified. In accounting for the application of funds during a year, only those outlays which are capitalized, shown as an increase in plant and equipment, are included as use of funds. Repairs, R&D expenditures, and, in the case of oil companies, a considerable expenditure for discovery and development, are capital stock maintenance outlays that perform the same function as "capital outlays", but they are netted against gross income from sales, i.e., are accounted for as if they reduced cash flow, not as an application of funds.

Capital Outlays

Item	1971	1972	1973	1974	1975	1976	1977
	(. . . . . dollar amounts in billions . . . .)						
Oil and gas extraction:							
Outlays	$0.8	$1.1	$1.5	$1.9	$2.4	$2.6	$3.3
Percent of:							
Cash flow	102	127	125	92	115	110	108
Total sources	66	69	71	71	74	74	74
Integrated petroleum and refining:							
Outlays	$11.0	$10.9	$11.9	$19.4	$20.9	$22.4	$24.6
Percent of:							
Cash flow	82	81	64	77	113	96	92
Total sources	64	64	51	53	72	67	72
Other manufacturing							
Outlays	$21.1	$21.1	$28.7	$37.1	$34.3	$35.6	$42.8
Percent of:							
Cash flow	63	57	62	78	69	58	62
Total sources	60	59	61	66	65	61	60

Source: Appendix Table XI.

With these precautions in mind, we may observe that, in 1977, oil companies made capital outlays of $27.9 billion. Extraction companies accounted for $3.3 billion, an amount exceeding their cash flow by 8 percent that year and equal to 74 percent of their total sources of funds. The remaining $24.6 billion expended by integrated companies represented 92 percent of their cash flow and 72 percent of their total sources of funds. Extraction companies quadrupled their annual capital outlays between 1971 and 1977 and, except in 1974 when cash flow was swollen by the sharp OPEC price increases in January of that year, outlays throughout the period exceeded 100 percent of cash flow and constituted an increasing proportion of total sources. This is what we would expect for an industry with good profit prospects. The industry's investments would exceed cash flow and the industry would have no difficulty in attracting external financing for its capital outlays.

Expectedly, the integrated companies present an investment behavior pattern between the extraction companies and nonoil corporations. Integrated companies comprise a blend of extraction and manufacturing activities. Thus they generally devote more of both their cash flow and total sources to capital outlays than nonoil companies, except in 1973-74 when they experienced a larger increase in cash flow. Integrated oil companies have more than doubled annual capital outlays and generally increased the fraction of cash flow and total sources of funds devoted to capital formation. And unlike the nonoil companies whose outlays were lower in 1975 and 1976 than they had been in 1974, both classes of oil companies sustained outlay growth.

Before reviewing the last major use of funds, for investments in securities and acquisitions of other firms, I should like to supplement the foregoing review of capital outlay statistics with supplementary data. The financial statistics we have been reviewing cover all the diverse operations of corporations that have been classified as principally engaged in the oil business, and they include both foreign and domestic operations. Since our principal interest today is in investment expenditures directly related to oil and gas productive capacity in the United States, it is illuminating to examine a statistical series explicitly devoted to such expenditures.

The Joint Association Survey, a compilation prepared by the American Petroleum Institute on behalf of the Institute, the Independent Petroleum Association, and the Mid-Continent Oil and Gas Association has provided estimates of exploration and development expenditures within the United States since

1966; and since 1973, the Bureau of the Census has prepared similar estimates as part of its Current Industry Reports series. Both estimates are based on survey techniques. In 1977, these sources estimated that a total of $16.9 billion was expended on oil and gas field exploration and development.

Exploration and Development Outlays

Type	1971	1972	1973	1974	1975	1976	1977
	(.			billions	. . . .)		
Exploration: total	$2.3	$3.5	$5.5	$8.7	$5.3	$7.2	$7.8
Land acquisition	0.6	1.7	3.6	5.8	1.6	3.0	2.6
Other	1.7	1.8	1.9	2.9	3.7	4.2	5.2
Development	$2.6	$3.0	$3.0	$4.4	$6.4	$7.7	$9.1

Sources: Joint Association Survey and Census Annual Survey of Oil and Gas.

You should bear in mind that this $16.9 billion of expenditures in 1977 cannot be compared to the $27.9 billion of capital outlays referred to above; the $16.9 billion includes expenditures by companies not included in the Compustat file, expenditures that would be financially expensed, and is restricted to U.S. expenditures of this type. Over the period, these expenditures have more than tripled from the $4.9 billion 1971 level. Except for irregular bulges in land acquisition expenditures -- mostly lease bonsues paid for mineral rights -- expenditures for this critical kind of capital formation have steadily increased during the period.

<u>Securities Purchases and Acquisitions</u>. Finally, because economic prospects may not warrant expenditure of all available funds for capital items to be employed in the company's existing lines of activity, and because our income tax laws discourage the pay-out of currently excess funds to stockholders, funds may be used to acquire other firms (within or outside of the company's own lines of activity) or make investments in securities. Some amount of investment in securities and for the acquisition of other corporations by oil companies has taken place. In 1977 $672 million of such investments outside the oil companies' existing activities occurred. For the oil extraction companies, this utilizied about one percent of available funds sources; for

integrated refining companies, two percent. However, these investments by integrated companies were large in 1974 and 1975; the $4 billion spent those two years represented an increased share of funds already enlarged by the OPEC price increases.

Investments and Acquisitions

Item	1971	1972	1973	1974	1975	1976	1977
	(. . . . . . . dollar amounts in millions . . . . .)						
Oil and gas extraction:							
Funds used	$59	$48	$33	$23	($44)*	$169	$46
Percent of:							
Cash flow	7	6	3	1	-	7	1
Total sources	5	3	2	1	-	5	1
Integrated petroleum and refining:							
Funds used	$883	$846	$574	$2,611	$1,438	$827	$626
Percent of:							
Cash flow	7	6	3	10	8	4	2
Total sources	5	5	2	7	5	2	2
Other manufacturing:							
Funds used	$1,118	$1,533	$2,036	$1,230	$1,312	$1,380	$2,651
Percent of:							
Cash flow	3	4	4	3	3	2	4
Total sources	3	4	4	2	3	2	4

*Net reduction in investments; sale of subsidiary.

Source: Appendix Table XI.

Two final qualifying observations are in order. First, it should be noted that the investments compiled here only cover mergers and similar combinations that are financed by the direct use of the acquiring company's funds. Thus, in 1974, the purchase of a 54 percent interest in Marcor by Mobil is included in the $2.6 billion presented above; but the 1976 completion of the merger is not shown, since it was consummated by an exchange of securities. Second, it is worth noting that not all the acquisitions encompassed in the total above take the acquiring company outside the industry in which it is predominantly engaged. Petro-chemical companies, refiners, oil producers and other related oil businesses, along with other mineral activities are the most frequent purchases of oil companies. Selected examples of oil company acquisitions in recent years are presented in Appendix Table XII.

Impact of President's Proposals

Phased decontrol of oil will increase the net oil receipts of producers and royalty owners by $15.4 billion over the 3-year period 1979-81 (assuming no increase in real OPEC prices). These increases in income are essentially windfalls; they are unexpected. When the producers and royalty owners made investments, they never anticipated that oil might rise to $13 or $16 a barrel.

If the President's windfall profits tax is not enacted, the producers and royalty owners out of the increased receipts will pay State severance, ad valorem, and income taxes, and the Federal income tax. After paying these taxes, they will have $8.0 billion left. The windfall profits tax will further reduce the after-tax revenues from decontrol received by producers and private royalty owners to $6.0 billion. Thus the proposed windfall profits tax will reduce the after-tax income received by producers and private royalty owners by 25 percent over the 3-year period, 1979-81.

Disposition of Net Increase in Oil Receipts, Assuming
Base Case -- No Increase in Real OPEC Price

	Calendar Years				Total	Total
	1979	1980	1981	1982	1979-81	1979-82
Net increase in oil receipts	1.0	5.0	9.3	10.9	15.4	26.3
Net increase in after-tax producer and royalty income						
without windfall profits tax	0.5	2.6	4.9	5.7	8.0	13.7
with windfall profits tax	0.5	2.1	3.4	3.9	6.0	9.9
% Reduction due to windfall profits tax	-	18.4%	31.3%	30.8%	25.1%	27.4%

Source: Appendix Table XIII.

If OPEC prices increase by 3 percent in real terms each year, the windfall profits tax will reduce by 40 to 45 percent the amount of money that the oil industry will actually keep as a result of decontrol. The President's proposed windfall profits tax is not the pussycat tax that some have suggested.

Disposition of Net Increase in Oil Receipts, Assuming Alternate Case -- 3% Increase in Real OPEC Price

	Calendar Years				Total	Total
	1979	1980	1981	1982	1979-81	1979-82
Net increase in oil receipts	1.0	5.3	10.7	13.7	17.0	30.7
Net increase in after-tax producer and royalty income without windfall profits tax	0.5	2.5	5.0	6.3	8.1	14.4
with windfall profits tax	0.5	1.9	2.9	3.5	5.4	8.8
% Reduction due to windfall profits tax	-	23.5%	42.0%	45.4%	33.5%	38.7%

Source: Appendix Table XIII.

The Treasury estimates of the impact of this program are by no means static estimates. In fact they assume considerable response -- or feedback, if you will -- on domestic crude oil production as the result of the increase in oil prices. By 1985, we assume that scheduled decontrol will increase domestic production by about 1.5 million barrels per day, roughly a 20 percent increase over the volume of production which would have prevailed under continued price controls. Consequently, in calculating our revenue impact we have taken into account not only increased oil receipts resulting from higher prices on production which would have occurred anyway, but also additional increases in oil production receipts resulting from price-induced production increases.

With respect to price-induced production increases, our 40 percent income tax rate is applicable only to net changes in producer's income since higher levels of production obviously are associated with higher levels of deductible production costs. Since this has been an apparent point of confusion leading to some public criticism of our analysis, I have shown in Appendix Table XIV both the 40 percent Federal income tax rate which would apply to net increases in oil receipts (net of production costs before deduction of state income and severance taxes) as well as the income tax rates which can be applied to the gross increases in oil receipts. This implied Federal income tax rate on gross increases is 34 percent in 1979, when relatively little induced production occurs, and declines to 20 percent by 1985, when induced production accounts for nearly 17 percent of total domestic output.

This concludes my testimony. I would be most pleased to respond to your questions.

o O o

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

FOR RELEASE UPON DELIVERY
Expected at 10:00 A.M.
Tuesday, May 8, 1979

TESTIMONY OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
SENATE APPROPRIATIONS SUBCOMMITTEE ON TREASURY
POSTAL SERVICE AND GENERAL GOVERNMENT

I am pleased to be here with you to discuss the Department of the Treasury's budget request for fiscal year 1980 and the current state of the economy and the prospects for inflation.

As your schedule indicates, the Treasury bureau heads will appear later before this Committee to justify their individual requests in detail. I would, however, like to discuss in summary the budget proposals that we have included in our requests, as well as some comments on the state of the economy and the Administration's economic policy. At the conclusion of my statement, I will be pleased to discuss any matters relating to the bureaus which the Committee may wish to review with me.

ECONOMIC POLICY

The American economy is at a critical juncture. Since the deep recession of 1974-75, we have enjoyed an impressive recovery of employment and production. We have had less success in maintaining the purchasing power of our currency.

This imbalance in our achievements cannot persist. Unless we right the balance ourselves by bringing inflation under orderly control, vents could 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.

Recent Economic Developments

The pace of economic activity has fluctuated widely over the past 15 months. Paralyzed by violent weather conditions and a coal strike, economic expansion ground to a halt in the winter of 1978, but bounced back vigorously last spring as consumer spending strengthened. During the summer months, consumer buying abated, as did the growth rate of real GNP. But in the autumn and early winter, consumers returned to the shops -- and business capital spending accelerated -- to lead another resurgence in overall economic activity.

In the final months of 1978, the economy was charging ahead at a clearly unsustainable rate. Real growth in the fourth quarter was almost 7 percent, at an annual rate, more than double our estimate of the economy's long-term growth potential, and well above the 5 percent average rate of real growth during the current expansion. Coming as it did in the fourth year of cyclical recovery, with only narrow margins of unutilized skilled labor and industrial capacity remaining, this unexpected upsurge in real growth was reflected in an accelerating rise in costs and prices. In combination, real growth and inflation added up in the fourth quarter to more than a 15 percent annual rate of increase in gross national product at current prices -- a rate exceeded only twice before in the current expansion.

The pace of overall economic activity has slowed markedly in the early months of this year as reflected in the first quarter GNP results. Some of this slowing has reflected adverse weather, some has reflected a normal let-up in consumer spending following the surge in buying in late 1978, some has reflected the pinch on purchasing power as inflation has outpaced wages.

But at the same time the consumer has held back, we have seen efforts by businesses to rebuild inventories in anticipation of work stoppages and higher prices, to accelerate ordering as delivery times lengthen, to borrow more heavily to finance outlays. The pressure of these business demands, added to the pressures pushing up prices of food and energy, have resulted in an acceleration in inflation.

The Recent Inflation Record

The rate of advance in prices in recent months is running far above acceptable levels. Consumer prices rose over the first three months of 1979, at an annual rate of 13 percent. This compares with a 9 percent rise in 1978 and just under 7 percent during 1977.

In part, the recent bad news on the inflation front reflects special unfavorable developments in farm and food prices. Part of the sharp January rise in food prices was due to severe weather in the Midwest and strikes in California. Meat prices rose nearly 5 percent in February alone. Some of these and other special factors will not be present later in the year. In April, agricultural prices declined for the first time since November.

But acceleration has also been taking place across a broad range of other prices. Home ownership costs, apparel prices, automobile prices -- all have been rising at an increasing rate. Clearly, the recent acceleration is not all due to special and temporary factors.

Recent developments in wholesale prices have been particularly disappointing. The producer index for finished goods has risen at a 13 percent annual rate so far this year. Farther down the production chain at the intermediate and crude materials levels, rates of increase have been even faster. This has built up pressures which will push up retail prices for the next few months. With delivery times slowing and rates of capacity utilization relatively high, demand pressures are clearly a major factor behind the recent deterioration in wholesale price performance.

More bad price news is possible in the months to come. In addition to rapid increases in materials costs, prices will be under upward pressure from rising unit labor costs. Productivity performance continues to be poor, growing less than half a percent over the past four quarters, while labor compensation costs continue to rise rapidly, not as a result of accelerating wage rates so much as a result of the increase in minimum wages and social security taxes at the beginning of the year. The combination of rising material and labor costs will put profit margins under pressure; in the context of strong market demands and long order backlogs, such pressures are likely to be reflected in efforts to maintain margins by boosting prices.

Hopefully, however, the policy actions already put in effect will result in some moderation in inflation as the year progresses, by precluding a resurgence in aggregate demand. The austere budget for FY 1980 proposed by the President will reduce the Federal Government's share of demand placed on our physical and financial resources. And the Administration's effort to reduce the cost and complexity of regulation will also contribute to a lessening of inflationary pressures.

Moreover, the most severe feedback effects on domestic prices from last year's depreciation of the dollar have already been felt. The stabilization of the dollar since our November 1 actions will alleviate some of the pressure on domestic prices induced by a weakening dollar.

Finally, the wage/price deceleration program has been tightened in a number of respects, to prevent sudden sharp jolts to prices such as were experienced earlier this year.

As these general and specific measures take hold, and as some of the special factors fade from the picture, the latest upsurge in inflation should begin to moderate. By persisting with policies of austerity and restraint, we shall begin to make some progress in bringing inflation down from the double-digit range.

The Longer-Term Program

While some abatement in inflation is expected this year, we have to recognize that significant and enduring abatement requires persistent application of restraint. There is no quick cure for an inflation that has been building for over a decade. And there are no easy ways out. Unless the growth of aggregate demand is restrained, demand-pull inflation will be super-imposed on cost-push, and inflation will accelerate even further.

Incomes policies, such as the voluntary wage/price deceleration program, can play an important part in containing inflationary pressures. But they can be effective only in the context of macro economic policies that limit the growth in aggregate demand to the growth in resource availability.

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 was illustrated sharply and painfully. 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. Perhaps as much as 1 percentage point of the 9 percent inflation last year can be traced to the weakening of the dollar.

The President moved forcefully on November 1st to put an end to this vicious cycle. He endorsed an increase in 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.

Our determination was tested and we, along with our partners in this arrangement, intervened heavily to halt the speculation. We withstood the test. Conditions in the foreign exchange market have clearly improved since November 1. The severe and persistent disturbances which characterized the markets last fall have been overcome and all of the resources actually used by the U.S. in the period following November 1 have been regained. Much of the speculative movement has been reversed. From its low point on October 31, the dollar has recovered on a trade-weighted basis by about 12 1/2 percent relative to OECD currencies. Against the DM, the Swiss franc, and the yen, the dollar has appreciated by 9 to 27 percent.

Uncertainties regarding oil supplies and prices are the principal source of concern in the foreign exchange market in recent months. While the dollar has been quite firm during this period of market uncertainity, the continued long-run health of both our currency and our economy requires a clear, firm and constructive energy policy.

The energy program announced by the President on April 5 is clear, firm and constructive. The commitment to end the subsidization of oil imports, by permitting prices of domestic oil output to rise gradually to world price levels, offers powerful incentives to increase domestic production and, correspondingly, reduce our dependence on foreign oil. In the short-run, there will be a modest upward push to the inflation rate. But the cost of our phased decontrol program is trivial relative to the costs we are already paying for excessive dependence on imported oil, and the even higher costs to which we would remain exposed unless we reduce this dependence. At the same time, the windfall profits tax revenues will fund more agressive development of alternative energy sources.

It should be noted, Mr. Chairman, that the Treasury Department recently completed an exhaustive, year-long study of the effects on our national security of our heavy dependence on imported oil. Such studies are authorized under Section 232 of the Trade Expansion Act of 1962. The findings of the study -- which involve many offices of our Department -- contributed significantly to the decisions reached in formulating the new energy program.

TREASURY DEPARTMENT FISCAL YEAR 1980 OVERVIEW

At this point, I would like to review briefly some of the other major programs of the Department, and our budgetary requirements covering our many and varied responsibilities. 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.

In keeping with the President's efforts to prevent a runaway growth of government, minimize inflation,and produce a balanced budget by 1981, we have tightened our belts and requested additional resources only where the workload clearly dictates. On the other hand, while we are trying to set an example of efficiency and economy, we have not sought to reduce spending levels below levels that are essential if the Department is to carry out its responsibilities relating to the financial and economic affairs of the Nation. We have attempted to protect our revenue production capacity and carry out effectively our law enforcement duties. I am sure the testimony of the bureau officials will make these points very clear to the Committee.

I do want to bring to the Committee's attention the type and level of workload facing the Department in FY 1980. 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 estimate that we will be issuing 726 million checks from our disbursing centers (24 million more than in 1979); producing 15 billion coins, (15 percent more than 1979); issuing, servicing and redeeming 293 million bonds and securities and introducing a new EE and HH series of savings bonds to replace the existing E and H series; processing approximately 137 million tax returns (2 percent more than 1970); processing 300 million or more arriving persons (4 percent over 1979); and 4 million formal Customs entries, (7 percent over 1979). 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 has been withdrawn was recently published in the Federal Register.

An important element in improving the productivity of the Department is the Bureau of the Mint's request 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. A Treasury Department Task Force is currently conducting a study of this question under the standards set forth in OMB Circular A-76. I am pleased to note that as a result of the review of refining operations, productivity has already significantly increased at the Assay Office. The work force has decreased from more than 190 employees to 165 employees, whole output of refined gold has increased 25 percent. Bids will be received from private refineries at the New York Assay Office on July 15 and will then be evaluated to determine if the Assay Office has sufficiently increased productivity to be competitive with private sector refineries. I am sure that the Task Force, which is composed of representatives of my office and the Mint, will present a fair and objective report regarding the future of New York Assay Office refining. The Department's decision on this issue is expected by the end of July.

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 ($19 million for workload and $26 million for program improvements), 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. Attachment A describes in further detail the major increases requested for the Treasury bureaus.

In addition, attachments B, C, and D show your Committee how these increases compare to our fiscal year 1979 level.

Mr. Chairman, the budget before you is a lean request. The minor program increases have been substantially offset by program reductions and other cost savings actions. We have reduced the total request for personnel by 539 while at the same time providing for the accomplishment of the projected fiscal year 1980 workload increases.

This completes my statement on the FY 1980 budget request for the Department. I shall, of course, welcome the opportunity to answer any questions you may have. Thank you.

Attachment A

THE DEPARTMENT OF THE TREASURY

Additional Detail on FY 1980 Budget Increase

Program Increases for Workload

To meet workload increases, we are requesting an additional $35.5 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.

An increase of $16 million is requested for the U.S. 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.

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 $9.7 million for program improvements. This represents less than a half of a percent of our proposed authorized level for 1979.

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 containerzied 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, $1.4 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 Ooperating 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 $543 million in one-time 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 a net of the following: price and other mandatory increases, $138.0 million; reduction for one-time payments to states, $543.0 million; other one-time costs, savings and program reductions, $96.3 million.

Nearly 60 percent of the $138 million for price and other mandatory increases is needed for the full-year cost of programs and pay increases authorizied in 1979, and for two additional workdays in 1980. The remaining increases in this area 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 of our desire to restrain growth in Federal expenditures.

Attachment B

THE DEPARTMENT OF THE TREASURY

Operating Accounts Appropriations
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 Approporiations:			
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	789.7	9.4
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	140.9	157.0	17.0
TOTAL, Regulation Operating Appro.	$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).

Attachment C

THE DEPARTMENT OF THE TREASURY

Operating Accounts
Comparative Statement of Average Positions
Fiscal Year 1979 and 1980
(Direct Appripriations 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
Investigations 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.

Attachment D

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 find 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 and 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 in 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..............................	38,517	
(g) Secret Service - to provide for the increase cost of protective travel.......................	700	+ 61,605
Proposed Authorized Level for 1979		$3,873,109

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

FOR IMMEDIATE RELEASE May 7, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 3,002 million of 13-week Treasury bills and for $3,001 million of 26-week Treasury bills, both series to be issued on May 10, 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 August 9, 1979			26-week bills maturing November 8, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.573 a/	9.601%	10.00%	95.148	9.597%	10.25%
Low	97.566	9.629%	10.03%	95.131	9.631%	10.29%
Average	97.568	9.621%	10.03%	95.138	9.617%	10.28%

a/ Excepting 1 tender of $2,865,000

Tenders at the low price for the 13-week bills were allotted 55%.
Tenders at the low price for the 26-week bills were allotted 92%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 50,995,000	$ 40,995,000	$ 52,575,000	$ 37,575,000
New York	4,891,155,000	2,587,290,000	4,480,130,000	2,605,570,000
Philadelphia	23,815,000	22,330,000	19,030,000	9,030,000
Cleveland	28,305,000	28,305,000	73,710,000	24,310,000
Richmond	32,075,000	27,065,000	20,870,000	20,870,000
Atlanta	41,335,000	41,335,000	27,475,000	27,475,000
Chicago	243,800,000	59,150,000	227,055,000	62,055,000
St. Louis	41,250,000	16,250,000	34,965,000	12,965,000
Minneapolis	18,335,000	8,020,000	14,950,000	14,950,000
Kansas City	23,070,000	21,070,000	28,775,000	28,675,000
Dallas	24,430,000	14,430,000	9,695,000	9,695,000
San Francisco	318,720,000	116,470,000	261,495,000	121,495,000
Treasury	18,990,000	18,990,000	26,135,000	26,135,000
TOTALS	$5,756,275,000	$3,001,700,000 b/	$5,276,860,000	$3,000,800,000 c/

b/Includes $ 446,290,000 noncompetitive tenders from the public.
c/Includes $ 341,915,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

B-1584

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

FOR IMMEDIATE RELEASE
May 7, 1979

Contact: George G. Ross
202/566-2356

UNITED STATES AND COSTA RICA
TO DISCUSS INCOME TAX TREATY

The Treasury Department today announced that representatives of the United States and Costa Rica will meet in San Jose in late May to begin preliminary discussions on an income tax treaty between the two countries. There currently is no income tax treaty between the United States and Costa Rica.

The proposed treaty is intended to prevent double taxation and to facilitate trade and investment between the two countries. It will be concerned with the taxation of income from business, investment and personal services, and with procedures for administering the provisions of the treaty.

The new treaty is expected to take into account the 1977 "model" income tax convention of the Organization for Economic Cooperation and Development, the May 17, 1977, United States "model" income tax convention, and recent treaties entered into by the United States.

The Treasury Department invites comments or suggestions concerning the forthcoming discussions to be in writing, and submitted, as soon as possible, to H. David Rosenbloom, International Tax Counsel, Room 3064, U. S. Treasury Department, Washington, D. C. 20220. Since the negotiations are likely tc continue beyond the May meeting, even those comments received after that time will be considered.

This notice will appear in the Federal Register of May 10, 1979.

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

FOR IMMEDIATE RELEASE
May 7, 1979

Contact: George G. Ross
202/566-2356

TREASURY RELEASES REPORT ON TAXATION OF
FOREIGN INVESTMENT IN U. S. REAL ESTATE

The Treasury Department today released a report titled, "Taxation of Foreign Investment in U. S. Real Estate." The Report finds that foreign persons can generally avoid paying U.S. tax on their capital gains when they sell U.S. real estate and recommends changes in U.S. law to prevent this tax avoidance.

The Report identifies various ways in which capital gains on real estate, ordinarily taxable, can legally be converted into capital gains on other assets which would not be taxable. A principal means by which this is accomplished is through a real property holding company, which allows capital gain on real estate to be converted into capital gains on corporate shares.

The Treasury does not believe that taxing capital gains on the sale of corporate shares is desirable or practical. But, to prevent unintended tax avoidance, the Treasury Report recommends modifying the specific statutory provisions under which foreign owners of U.S. real estate are able to convert taxable gain into nontaxable gain. The Report describes certain steps which may be taken in this regard. The Treasury plans to work with the Congress and with other agencies of the Government in developing formal legislative proposals in this area.

The Report also notes that rental income can be offset by deductions for maintenance and operating costs, property taxes, mortgage interest and depreciation but that these deductions are equally available to domestic and foreign property owners.

The Revenue Act of 1978 mandated that the Treasury Department undertake a full and complete study and analysis of the appropriate tax treatment of income derived from, and capital gain on the sale of U.S. real estate held by non-resident aliens and foreign corporations. This study, together with the recommendations of the Treasury Department, was to be submitted within six months of the date of enactment of the Revenue Act of 1978.

Copies of "Taxation of Foreign Investment in U.S. Real Estate" are available for purchase from the Superintendent of Documents, U.S. Government Printing Office, Washington, D. C. 20401. When ordering, use Stock No. 048-000-00327-3.

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B-1586

Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. May 8, 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 May 17, 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 $6,221 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 February 15, 1979, and to mature August 16, 1979 (CUSIP No. 912793 2G 0), originally issued in the amount of $2,907 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated May 17, 1979, and to mature November 15, 1979 (CUSIP No. 912793 2V 7).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing May 17, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,745 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 Daylight Saving time, Monday, May 14, 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-1587

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 May 17, 1979, in cash or other immediately available funds or in Treasury bills maturing May 17, 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 Upon Delivery
Expected at 2:00 p.m.

File Copy

STATEMENT OF
THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
COMMITTEE ON WAYS AND MEANS
May 9, 1979

Mr. Chairman and members of this distinguished Committee:

Today I come before you to consider yet again our nation's energy crisis -- particularly as it relates to crude oil.

I will first discuss the severe energy problems we face. Then, I will turn to our President's program: his bold decision to decontrol crude oil prices, the imposition of a windfall profits tax on domestic crude oil production, and the creation of an Energy Security Trust Fund to utilize the tax revenues generated by decontrol and the new windfall profits tax.

Nature of Our Energy Problem

Many Americans apparently still doubt the reality of the energy crisis. This is shocking. These doubts pose a serious threat to rational policy making. They must be dispelled with finality. It is beyond question by reasonable men that this nation faces energy problems that strike to the core of our political and economic security, and affect the very stability of our society.

The vast economy of the United States faces a central problem: the availability and cost of crude oil. The story can be told by a few numbers. In 1970, the posted price of light Saudi Arabian crude, the key indicator of world oil prices, was $1.60 per barrel. Today the posted price is

$14.54, a nominal increase of 708 percent. In 1970, the U.S. met 76.7 percent of its crude oil needs out of its own production. Today, we meet only 50 percent of our needs from our own production despite gains from Alaska. In 1970, 72.7 percent of our oil imports were supplied by Western Hemisphere nations (primarily Canada and Venezuela). Today, less than 20 percent of our imports come from these countries. In 1970, our oil import bill was $2.9 billion. We now expect our 1979 oil import bill to be about $52 billion.

Three times over the past 21 years -- in 1958, 1975, and 1979 -- senior economic policy officials have carefully examined, under Section 232 of the Trade Expansion Act and its predecessor, whether our national security is threatened by the volume and character of our oil imports. In each case the answer has been: Yes!

The national security elements are clear:

° Because so much of the oil used in the United States originates thousands of miles away, supplies are vulnerable to interruption for a variety of causes. As the oil embargo of 1973 and subsequent energy shortages have illustrated, interruptions in energy supplies seriously disrupt our economy.

° As our oil import bills have skyrocketed, our export growth has not been sufficient to balance our trade accounts. Large trade deficits have been the result, with the consequent risk of dollar depreciation. Excessive dollar depreciation can be extremely harmful to the American people because it increases domestic inflation and erodes personal income. Excessive dollar depreciation also hurts the entire world economy because the dollar is the dominant currency in world trade and finance.

° If we continue to rely more and more on uncertain foreign sources of oil, the independence and vigor of our foreign policy is put at risk.

° Cartel control of over 50 percent of the world's oil supply exacts an increasing drain on the real resources of the consuming nations. It jeopardizes their economic security and ability to plan their economic futures.

With world prices dictated by political forces, rather than by free markets, sensible inflation control becomes extremely difficult for the consuming nations.

° Our increasing oil imports play directly into the hands of the world oil cartel and add to upward pressures on world oil prices. Our oil imports today constitute 17 percent of world oil production. Absent increases in non-OPEC energy supplies, or a reduction in world oil consumption, rising U.S. oil imports will directly tighten the world market and undercut efforts to encourage responsible and moderate oil policies by the OPEC nations.

° Finally, as escalating U.S. oil imports suggest, this country is not yet making a determined and creative transition to a world in which oil supplies are scarce, expensive, and often unreliable. We are continuing to use energy, and particularly oil, at a far too lavish rate, and we are failing to make those long-term investments in alternate energy technologies that will be essential to our economic and political security in the remaining years of this century.

These are enormous problems. President Carter, to his everlasting credit, has chosen to address them. Last year, with the National Energy Act, we together took major strides to correct imperfections in our coal, natural gas, conservation, and utility rate policies. But, despite the hard and sound work of this Committee and its Chairman, the core issue -- crude oil policy -- was not resolved at that time.

By failing to act in this area, the federal government has left in place policies that actually aggravate our energy problems. Of these, the most perverse and serious is the system of price controls and entitlements imposed on domestic oil production.

The system originated with the comprehensive wage and price controls instituted by the Nixon Administration in 1971 and has operated in its present form since 1973. The system has grown steadily more complicated. At present, no single expert can pretend to understand how all the regulations work or whom they benefit. If ever a federal program deserved to be called a "bureaucratic nightmare", the regulation of U.S. oil prices has earned that distinction.

What is clear about the system is that it intensifies our energy problems. It does so by disguising from the American people -- consumers, investors, and industry alike -- what we are all really paying for oil. The system is, quite literally, an exercise in economic self-deception. Because of it, we use and import more oil than we should; we produce less domestic oil than we should; and we neglect to make economically sensible and necessary investments in alternative energy sources and technologies. Could there be any greater condemnation?

The oil pricing system has two components. First, it sets various ceiling prices for the domestic production of oil. Lower-tier oil -- production from fields in operation in 1973 -- is generally capped at about $6 per barrel. Upper-tier oil -- production from fields placed in operation since 1973 -- is capped at approximately $13 per barrel. Second, the system requires refiners to make payments -- known as "entitlements" -- to each other so that each refiner pays the same average price for a barrel of oil, regardless of the source of supply.

The results of these controls and regulations are rather obvious:

- The average price of oil to refiners, and thus to individual and industrial consumers of oil, is substantially less than the world price. For example, in February of this year, the country was facing a price of $15.80 a barrel for imported oil on the world market. But the controls-and-entitlements system established an average refiner price of $13.24 per barrel, regardless of source. As a consequence there was an effective, federally-mandated subsidy of $2.56 per barrel to import oil, rather than use domestic oil, and a like subsidy to consume oil, rather than to conserve it or use some alternative form of energy, such as coal, natural gas, or solar energy.

- The incentive to produce oil domestically is artificially depressed. About 40 percent of domestic oil has been subject to the lower-tier cap of about $6, and another 30 percent to the upper-tier cap of about $13. Compared to a world price of $15.80 in February, these controls constituted a straightforward signal to oil owners to invest in more profitable ventures, either here or abroad.

In brief, since the OPEC-generated explosion of oil prices in 1973, the U.S. has been operating a program that encourages oil consumption and imports and discourages domestic oil production and the development of new energy sources. Although this has been done in the name of "protecting" the consumer, it has had precisely the opposite effect. By discouraging investments in domestic oil production and development of alternative energy sources, by enlarging the trade deficit and weakening the dollar, and by tightening world oil markets, these price control policies have added to upward price pressure not only on world oil prices but also on the general price level of all goods and services. Far from protecting the consumer, the domestic oil control system has instead served to aggravate inflation.

The President's Program

The President has recently addressed the critical problems created by our dependence on oil imports in the following ways.

- By agreeing with our allies in the International Energy Agency to reduce U.S. imports (by the fourth quarter of 1979) by up to 1 million barrels a day below levels expected prior to the 1979 OPEC price increases. This action --and similar actions by our allies -- should moderate future increases in world oil prices, reduce our trade deficit and strengthen the dollar.

- By phasing out price controls on domestic crude oil. This ends the subsidy to consumers of oil, encourages conservation and substitution of other energy sources, and provides appropriate incentives to expand domestic oil production.

- By proposing a windfall profits tax. This captures for the U.S. Treasury some of the excessive profits from existing oil wells and a portion of future windfalls generated by OPEC price increases, and creates a mechanism through which the U.S. can offset the effects of decontrol on the poor, encourage energy efficient mass transit and further its efforts at developing alternative energy sources.

The Decontrol Program

The key element in the President's program is the decontrol of crude oil prices. The route chosen will delay as much of the inflationary impact of decontrol until 1981 or 1982 as is practicable while maximizing the incentive to increase production in 1979 and 1980.

The major features of the decontrol program adopted by the President are:

- Producers of lower-tier oil (also called "old" oil) will be allowed to reduce the volume of output they are required to sell as old oil by 1-1/2 percent each month in 1979 and 3 percent each month from January, 1980 to September, 1981, determined from new control levels established as of January, 1979. This means that a property whose old oil control level is 100 barrels a day in January, 1979 will be required to sell as old oil only 82 barrels a day in December, 1979, and 46 barrels a day in December, 1980. Production above these levels may be sold as upper-tier oil.

- The price of upper-tier oil will be phased up to the world price beginning on January 1, 1980 and ending on October 1, 1981.

- As of June 1, 1979, newly discovered oil will be decontrolled, as will that volume of production from any oil field that results from introducing tertiary recovery programs.

- Production from marginal wells -- that is, wells producing less than specified amounts of oil in 1978 -- will be allowed to sell at the upper-tier price beginning June 1, 1979.

A key aspect of this program is the decontrol of old oil. From 1976 to 1978, oil price regulations gave the lowest return to those producers who made the greatest effort to increase production after the 1973 embargo, while giving the highest return to those producers who did the least to meet the national need after 1973. The decline rate change for lower-tier oil announced by the President eliminates the disincentive to produce from old oil fields, since the profit earned from increased production in old oil properties will be the same as from investments in new oil properties. From the standpoint of production incentives, a rapid decline rate is the most efficient method of decontrolling lower-tier oil.

A second critical element in the President's program is the decontrol of newly discovered oil and incremental production which results from the completion of tertiary recovery projects. No longer will exploration for new reserves in untapped areas be discouraged by a stifling system of price controls. Further, the incentive to invest in tertiary projects which involve risky efforts to apply expensive, experimental procedures to the recovery of additional oil from depleted reserves will be as great as the incentive to explore for newly discovered oil. This is as it should be in a competitive economy.

The Windfall Profits Tax

Decontrol is an essential step toward a sensible national energy policy. However, decontrol will create some windfall profits since, in many instances, the world price exceeds that necessary to induce rapid production and discovery. To recapture some of these windfall profits, while at the same time preserving production incentives, we have proposed a tax of 50 percent on the windfall profits per barrel generated by decontrol and by future OPEC price increases. An additional portion of the windfalls will automatically be recovered through existing federal income tax laws.

The Chairman of this Committee has introduced a windfall profits tax addressing the same concerns as the Administration's proposal. The Chairman's bill is similar to our proposal in most important respects and provides a sound basis for the Committee to explore the issues raised by the tax. The Administration greatly appreciates the efforts of the Chairman to play a major role once again in resolving our domestic crude oil problems in a sensitive and effective manner.

Our tax involves a 50 percent levy on three bases: the windfall profits from moving lower-tier oil to the upper tier; the windfall profits from moving upper-tier oil to the world price; and the windfall profits from future real increases in the world price. For percentage depletion purposes, gross income is reduced by the amount subject to the 50-percent tax.

A. Lower-tier

The tax on old oil would be equal to 50 percent of the difference between the price at which the oil is sold and the control price of the old oil. The control price is currently about $6.00 per barrel and is to be increased by inflation.

The Administration's tax on old oil is imposed on production which most likely would have come forth had controls remained in effect, so that genuine increases in production from old oil properties are not taxed. Specifically, the tax applies only to that volume of lower-tier oil freed to the upper tier under decontrol which exceeds the volume of oil which would be freed under a 2 percent decline rate after January 1, 1980.

Let me use a simple example to show how the tax works. If an old oil property were required to sell as old oil 100 barrels per day in January, 1979, we would tax production in future months as follows:

- Until 1980, no tax applies.

- In January, 1980, 80 barrels of daily production would be potentially taxable. However, since DOE would still require 79 of these barrels to be sold as old oil, only one barrel would be taxed. Production above 80 barrels per day would <u>not</u> be subject to the lower-tier windfall profits tax.

- In January, 1981, 56 barrels of daily production would be potentially taxable. However, since DOE would require that 43 barrels still be sold at the old oil price, only 13 barrels would be taxed. Production above 56 barrels per day would not be subject to the lower-tier windfall profits tax.

- In October, 1981, 38 barrels of daily production would be taxable. Since full decontrol would be in effect then, all 38 barrels would be taxed as lower-tier oil. Production above 38 barrels per day would not be subject to the lower-tier windfall profits tax.

The decontrol plan uses a 3 percent decline rate while the windfall profits tax uses a 2 percent rate. The difference is dictated by economics. As I noted above, a 3 percent decontrol decline rate was required to provide the incentive of replacement cost pricing for old oil properties and also to allow for a smooth transition to complete decontrol in 1981. Had a lower decline rate been employed, the "gap" when complete decontrol is required in 1981 would have been larger and the inflationary shock in 1982 greater.

However, the 3 percent decline rate exceeds the actual decline rate observed in almost every oil field. Thus, a 2 percent decline rate was selected for tax purposes as being closer to historical experience. Using a lower decline rate than 2 percent for tax purposes would obviously increase the amount of old oil subject to tax, but would risk discouraging production to some extent. The 2 percent decline for tax purposes represents a reasonable balance between capturing windfalls and assuring maximum production.

All production from a property which qualifies as a marginal property will be exempted from the lower-tier tax, and treated as upper-tier production. Marginal well taxation is based on the higher costs of production associated with these properties. The production costs per barrel for a 5,000 foot well which produces only 20 barrels a day are generally greater than for a well of the same depth which produces 500 barrels a day. Providing separate treatment for marginal wells is also consistent with the decision of the House last October to deregulate marginal oil completely.

B. Upper-Tier

The tax on upper-tier oil will be equal to 50 percent of the difference between the price the oil sells for and the inflation adjusted price of upper-tier oil. The upper-tier tax is structured differently from the lower-tier tax because upper-tier oil is to be decontrolled by ramping the control price to the world price level by October, 1981, rather than by using a decline rate mechanism. The tax would begin phasing out in November, 1986, and would disappear by January, 1990. The upper-tier tax will have little if any adverse impact on production of upper-tier oil since the control price was close to the world price before the recent OPEC surcharges.

The upper-tier tax is phased out in order to simplify the windfall profits tax at a point in time when fine distinctions are no longer needed. Computing the upper-tier tax requires reference to the last vestiges of price controls. Since revenue from the upper-tier tax will decrease substantially after 1985 as the volume of upper-tier oil diminishes, we decided to phase out the upper-tier tax after 1986.

The upper-tier tax excludes new production, incremental tertiary production and any oil subject to the lower-tier tax.

C. Uncontrolled tier

The upper- and lower-tier tax bases will cover about two-thirds of U.S. production. The remaining third is composed of output from the Alaskan North Slope, stripper wells (wells that produce less than 10 barrels a day for a 12-month period), newly discovered oil and incremental production resulting from the introduction of tertiary recovery procedures in old oil fields. These categories of production are now either decontrolled or effectively decontrolled, and thus are able to earn the world market price.

The third base of the windfall profits tax applies to this uncontrolled oil (other than Alaskan North Slope oil) to the extent not subject to the lower-tier or upper-tier tax. The 50-percent tax would be imposed on the difference between what the producer receives, and a base price of $16 per barrel as of January 1, 1980. The base would be adjusted for domestic inflation occurring after 1979. Eventually, the decontrolled tier tax would apply to all other domestic oil, as it is decontrolled.

The exemption of Alaskan North Slope oil is based on the economics of Alaskan production. According to the most recent DOE data, the average wellhead price of Alaskan crude was only $5.40 a barrel, due to the extraordinarily high transportation costs which must be incurred to bring this production to market. While this wellhead price will rise dollar-for-dollar with increases in the world price of oil, it would not reach $16 per barrel until the wellhead price of Saudi Arabian marker crude reaches $22 a barrel (in 1980 prices). Although prices of imported oil have been increasing rapidly over the last few months, we will not likely see posted prices at the $22 level in the near future. It is easier to exempt Alaskan production from the tax than to require Alaskan producers to file tax returns solely for the purpose of showing that no liability has been incurred.

A number of questions have been raised concerning the $16 per barrel base price for the uncontrolled tier tax. The $16 figure is based on the estimated world price which would be in effect as of the first quarter of 1980 as a result of the December, 1978 OPEC price announcement. The base price was calculated to allow for uncertainties about the difference between the posted price of Saudi Arabian marker crude, and transportation costs, quality differential and other relevant factors. By choosing $16, most domestically produced uncontrolled crude oil would pay no tax unless OPEC were to raise its prices in excess of inflation.

Second, it has been suggested that the $16 base be increased because recent OPEC surcharges have already increased the price of oil. However, the President's windfall profits tax proposal is designed to prevent domestic producers from benefiting from just these kinds of sudden price increases. There is no rational reason for exempting the profits domestic producers are realizing from these surcharges from the windfall profits tax.

Third, it has been argued that since the tax on the uncontrolled oil tier is permanent, the United States is permanently condemning producers to a lower price at home than they might realize abroad, and that the United States will produce less oil than would be produced in the absence of a permanent tax.

The world price of oil has major non-competitive aspects. Since 1973, it has been set well above the cost of production by a cartel. Given these circumstances, there is no economic reason for allowing domestic producers to receive the world price of oil on their production.

Moreover, it is simply not true that producers can earn even more abroad than they can at home if the uncontrolled tier tax is enacted. In every other producing country, increases in the price of oil have immediately been accompanied by increases in taxes on producers or by nationalization. Either action deprives the producer of the increased revenues. Even in the U.K., the tax on North Sea producers is designed to make the government the principal beneficiary of higher world oil prices. This same effect has been realized in Venezuela through nationalization. Similar examples can be found in most other countries.

Finally, those who argue that we will lose a small amount of domestic production due to the uncontrolled tier tax fail to recognize the risk of imposing no tax at all. Political forces will not allow complete and permanent decontrol of oil so long as we face an unqualified threat of embargoes and sudden price increases. In the absence of a permanent tax, a future surge in oil prices may compel a return to regulation. It is preferable to risk sacrificing the very small potential supply response in order to avoid such a situation. By imposing a permanent tax with a base which is adjusted for inflation, I believe we will, in the long run, allow producers to receive approximately the same price as is received outside the U.S. but with standby protection that will prevent them from receiving sudden windfall profits due to increases in prices as a result of anti-competitive cartel practices.

D. Further comments

I would like to respond to some of the general questions that have been raised about the President's windfall profits tax proposal.

It has been suggested, and I believe misleadingly so, that the Administration has proposed a "weak" tax. This is not so. Our goal is to capture windfalls without prejudicing production incentives. This we have done.

There are almost no exceptions to the upper-tier tax. The only exception to the uncontrolled-tier tax is the well-justified exclusion for Alaskan North Slope oil. The exceptions to the lower-tier tax are geared to ensure maximum possible production from domestic sources, and old oil exempt from the lower-tier tax is subject to the upper-tier tax. Furthermore, the uncontrolled tier tax is permanent, and captures half of all increases in oil industry revenues which are due to price increases beyond that which would be allowed solely by inflation.

Absent our windfall profits tax, producers would receive $0.43 net from each dollar increase in revenue. With the tax, the producer's take drops to $0.29 per dollar. Assuming oil prices do not increase in real terms beyond 1979, the tax reduces by 30 percent the amount of money which the oil industry would actually keep as a result of decontrol. If oil prices were to increase in real terms, say, by 3 percent per year, the tax would reduce industry revenues from decontrol by 40 to 45 percent.

Assertions that the tax is weak have in some instances been based on misleading comparisons. For example, comparisons are made between the gross revenues generated from decontrol -- before payment of any additional production costs and any taxes -- and the net federal tax receipts due to the windfall profits tax. These types of comparisons fail to take into account the automatic effect of other taxes and the increased expenditures for greater oil output. The proper comparison is between producer and royalty revenues with and without the windfall profits tax. Under this analysis, producer and royalty revenues are 30 to 45 percent lower with the windfall profits tax than without it.

It has also been said that the windfall profits tax denies capital required for further exploration. Such arguments are without economic foundation. The economic incentive is provided by the price of newly discovered oil, not by the cash flow from existing production. The argument for increased cash flow is untenable. It would lead to a cheap source of capital for those now engaged in the exploration for oil and gas while new entrants must pay the market price for capital. This is inconsistent with a competitive economy, because it would further impede entry by non-oil firms into oil production and thus reduce competition. Moreover, providing "free" capital means that the investment basis in oil property is reduced. To be consistent, the "cash flow" advocates should demand that such oil be sold at a lower price -- or perhaps given away -- since the investment has already been recovered.

A variation on the "cash flow" argument is plowback. Plowback is an offset against the windfall profits tax for certain oil-related investments. Plowback should be recognized for what it is: a subterfuge for repealing the windfall profits tax. This tax is being sought in part because some of the increased profits from decontrol are windfalls that do not lead to appreciably increased domestic oil production. Likewise, plowback -- which is merely a reduction in the tax -- will not necessarily add to domestic oil production.

Proponents of plowback argue that it provides a useful subsidy for domestic oil production. However, as a subsidy, plowback is deficient. Since plowback would be limited only to present owners of oil, it would provide no incentive to new entrants into production. This would discourage competition in the industry and encourage concentration. Moreover, plowback subsidies would be distributed only to the <u>owners</u> of interests in the oil, such as royalty holders. Not all owners <u>produce</u> oil, and it is production, not mere ownership, which should be encouraged. In addition, plowback would require complex and arbitrary definitions of threshhold or base period investment levels and of qualifying investments, leading to interminable administrative disputes and litigation.

Finally, some have challenged the windfall profits tax proposal on the basis that we subject no other windfall to a special tax. This argument ignores the very special circumstances of the domestic oil industry. Windfalls are most commonly found among commodities, such as oil. In most cases, however, competition and the legal structure of the market rest within the authority of the United States. This is simply not the case with respect to oil prices. The windfalls are attributable to the action of a foreign cartel, totally outside the legal control of the United States. There is simply no sound reason why we must stand idly by and permit windfalls to be reaped in the United States because of actions taken by a foreign cartel.

Energy Security Trust Fund

The President has proposed to convert windfall profits derived from OPEC pricing into the direct advancement of energy technology, the development of energy efficient mass transit, and for assistance to those least able to afford energy price increases attributable to decontrol. This will be done through the Energy Security Trust Fund. I will outline the Fund in very broad terms. The Director of OMB, Jim McIntyre, who will be appearing before you shortly, will describe the Fund in greater detail.

The Fund will consist of the proceeds of the windfall profits tax, and increased federal income taxes attributable to decontrol during the deregulation period. The Fund is an addition to, and not a replacement of, existing Department of Energy funding.

The cost of all Fund programs will be limited to Fund resources. The new programs will be undertaken only if the windfall profits tax is enacted. The cost of any new energy tax expenditures will be charged against Fund receipts in order to control these subsidies more effectively. All spending programs financed from the Fund will be subject to annual authorization and appropriation. Given available funds, additional initiatives may be undertaken to reduce U.S. oil import dependence.

The Treasury Department will be responsible for holding the Fund, and for estimates of revenues and tax expenditures. On the basis of these estimates, and estimates made by OMB of other demands on the Fund, the extent of Fund resources available will be determined.

Economic Impacts

We estimate that the additional inflation resulting from phased decontrol compared to retaining controls indefinitely amounts to about 0.1 percent in 1979 and averages 0.2 percent a year over the next three years. By 1982, the level of the consumer price index will be approximately 0.75 percent higher with phased decontrol than if controls had been retained indefinitely.

These estimates assume that OPEC prices rise only as fast as world inflation. If world oil prices increase faster than world inflation, the inflationary impact of decontrol would be slightly greater. For example, if world oil prices increase 3 percent a year faster than world inflation, the level of the consumer price index will be approximately 0.9 percent higher by 1982. Thus, inflation is not very responsive to faster OPEC price increases. This is because price controls govern only a third of all U.S. oil consumption. The remaining two-thirds (imports, stripper production, and Alaskan oil) are already free to receive the world price.

These inflation estimates are based only on quantifiable decontrol effects, such as the higher prices of gasoline, heating oil, and goods manufactured from petroleum, and the induced impact on prices resulting from wage increases caused by cost of living adjustments made in response to the additional inflation. The estimates do not include any effects from reduced prices of non-energy imports due to the strengthening of the dollar, and from the lower oil prices which would result from future world oil price moderation due to reduced U.S. demand. The excluded effects are simply not quantifiable. Since the nonquantifiable elements suggest lower inflation impacts, it is probable that our numbers overstate the effect of decontrol on inflation.

Decontrol will restrain aggregate demand and economic growth slightly over the next two years -- by perhaps 0.1 percent a year. In later periods, fiscal and monetary policy can be adjusted to the needs of the economy as they develop, taking into account the specific economic impacts of decontrol and expenditures from the Energy Security Trust Fund.

The Department of Energy estimates that, relative to continued price controls, the President's program will reduce oil imports by about 370,000 barrels per day in 1981 and 950,000 barrels per day by 1985, assuming OPEC prices increase only with worldwide inflation. Should OPEC raise prices at a rate in excess of worldwide inflation, the oil import savings would be greater. DOE has estimated that imports would be reduced by 440,000 barrels per day in 1981 and 1,100,000 barrels per day in 1985 under a case where OPEC raised its prices at a rate which was 3 percent per year greater than worldwide inflation.

Conclusion

The U.S. faces a severe energy problem today despite recent corrective measures. At the root of our present energy problem is the price of oil. In the past we have refused to address this problem because of the windfall profits involved. We can no longer afford to avoid the issue. By artificially suppressing the price of oil, too much oil is consumed and too little produced; other efforts to solve our energy problem are frustrated; and less incentive to switch to other fuels or to conserve energy is provided.

President Carter has recognized this dilemma. He has acted to decontrol crude oil prices permanently by the end of 1981. He has also addressed in an effective manner the issue of windfall profits created by decontrol. Now he needs your assistance in passing a windfall profits tax and creating an Energy Security Trust Fund.

I look forward to working with this Committee in taking these next steps in resolving our energy problem.

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REMARKS BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
INSTITUTIONAL INVESTORS INSTITUTE
ANNUAL WASHINGTON ROUNDTABLE
WASHINGTON, D.C.

The Outlook for World Trade: Continued Liberalization or Protectionism?

There has been considerable talk in recent months about where we are going in world trade:

-- Pressures for import restraints have been strong throughout the past three to four years in response to slow recovery from the 1975 global recession and continued economic difficulties in particular industrial sectors.

-- The International Monetary Fund has argued that the safeguard or escape clause actions adopted by a number of nations since 1976, together with the increase in antidumping and countervailing duty actions and the negotiation of orderly marketing arrangements in certain sectors, constitute a clear and continuous retreat from liberal trade.

-- Some have argued that liberal trade is bound to suffer in periods of high unemployment and slow economic growth and that the prospect for continued slow growth and increasing competition from both Japan and the advanced developing nations presages a clear protectionist trend for the period ahead.

-- Some have even called for stringent import controls as the only means of "balancing" trade for the United States and other major deficit nations, providing us with a protective barrier from excessively competitive Japanese and developing nation trade behind which to stimulate domestic economies and spur export growth.

Are import restraints becoming not only politically attractive, but intellectually respectable as well? Has the international community already chosen to follow a protectionist path?

I don't think so:

-- In spite of the recent actions by a number of countries to safeguard a few domestic industries from rapid surges in imports, there has been real net progress toward trade liberalization since the late 1960s. I'll discuss some of these liberalizing moves in a moment.

-- The recently concluded Multilateral Trade Negotiations represent the international community's most comprehensive attempt ever to address the full spectrum of restraints on international trade, providing not only a substantial reduction in industrial tariffs but also new codes governing the use of government standards, procurement, and customs valuation, which should significantly reduce these non-tariff barriers to trade.

-- The new code on subsidies and countervailing measures will also bring much-needed discipline to one of the most contentious areas of government intervention in trade and should help strengthen global support for liberal trade by assuring that trade will also be fair.

-- Although increasing competition from the developing nations will require fundamental structural adjustment in the industrial nations -- which will take time -- the importance of lower cost imports in fighting domestic inflation, the political necessity of improved North-South cooperation, and the increasing dependence of the industrial countries on exports to the developing nations to pay for essential imports should argue strongly against widespread import restraints by the industrial nations.

History, international agreements, and self-interest all come down on the side of the continued trend toward trade liberalization, rather than protectionism. I'd like to discuss each of these areas today.

<u>Trade Trends, 1950-1970</u>

From the end of World War II until the completion of the Kennedy Round of trade negotiations in 1967, world trade grew approximately three-fold in value from less than \$60 billion to roughly \$190 billion. It doubled again, to \$375 billion, by 1972, when the staged tariff cuts were completed. This dramatic expansion was facilitated by a commitment among the industrial nations to long-term trade liberalization and strong economic growth in virtually all nations. Between 1958 and 1970 world exports grew at an average annual rate of nearly 10 percent. Exports of the OECD nations[1/] grew at a substantially faster rate than the growth of gross national product -- by factors of 1.4 for France and Japan, 1.5 for the United Kingdom, 1.6 for Canada and Germany, 1.9 for the United States, and 2.5 for Italy between 1955 and 1970, allowing for changes in prices. From 1968 to 1970, in fact, exports were growing <u>twice</u> as fast as domestic production.

The structure of trade also changed dramatically. The share of industrial nations' exports in world trade rose from 50 percent in 1950 to 72 percent in 1970, while the developing countries' share fell from 32 percent to 17 percent over this period -- despite a substantial absolute increase in the value of their trade. This trend reflected the overall shift in the pattern of trade to more sophisticated products and the dramatic rebuilding of supply capabilities in Europe and Japan. The share of manufactures in world trade increased from 41 percent in 1950 to 65 percent in 1970, at the expense of trade in food and

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1/ Organization for Economic Cooperation and Development, including the 24 Western industrial nations.

primary products. The LDCs also increased the share of manufactures in their exports, from 15 percent in 1960 to 23 percent in 1970.

By the late 1960's and early 1970's, therefore:

-- Manufactures trade had clearly become the major arena for international competition, while political and social concerns in the agricultural area made liberalization of agricultural trade extremely difficult.

-- The LDCs had begun to increase their exports of manufactured goods, a trend which would gain even further momentum in the next few years.

-- Trade was becoming increasingly important to domestic economies in terms of dependence on imports and share of production going into export. In short, national economies were becoming highly integrated and increasingly interdependent.

-- Basic structural changes in the global economy were beginning to be felt in the industrial nations, together with a general difficulty in adjusting to these changes. High rates of inflation and unemployment began to coincide; the growth of real wages overtook the growth of productivity; and the growth of investment in manufacturing began to decline, while government subsidies to domestic production were becoming increasingly widespread. These trends would intensify during the 1970s, and would form the back-drop for later pressures for import restraints.

-- The system of fixed exchange rates adopted at Bretton Woods, which had provided a stable framework for the post-war expansion of trade, had also become outmoded. The dollar had become seriously overvalued, sharply weakening the international competitive position of the United States and producing understandable -- though misplaced -- calls for import controls. Change in the international monetary system was now essential to avoid the future distortion of trade patterns.

All of these factors argued for fundamental reform of the international trade and monetary systems during the 1970's. The international community had, in effect, reached a turning point. Pressures for import restraint were building, and continued liberalization would require a mutual political resolve to go well beyond the gains of the Kennedy Round.

Developments Since the Kennedy Round

The Kennedy Round of trade negotiations provided the most significant liberalization of international trade prior to the recent Tokyo Round of Multilateral Trade Negotiations. Liberalization focused on the reduction of industrial tariffs by the industrial nations, resulting in a weighted average reduction of about 35 percent over a period of five years. Total concessions involved trade of over $40 billion, or approximately one-fifth of total world trade in 1967. As a result of these negotiations, average tariff rates for the major industrial countries[2/] in 1973 were 6.2 percent on all imports and 10.7 percent on dutiable items only.

Agricultural trade was left virtually untouched by the Kennedy Round, as too politically sensitive. Non-tariff barriers were also not addressed, but would become increasingly important factors in international trade during the next decade.

In the aftermath of the Kennedy Round, a number of nations decided to complete their tariff reductions ahead of schedule, primarily as a means of countering inflationary pressures. Argentina put its Kennedy Round reductions into force in 1967, Iceland in 1968, Canada and Ireland in 1969 and Switzerland in 1970. The United States took a few steps in the other direction, introducing import quotas for meat and negotiating voluntary export restraints with principal steel suppliers in 1968.

But inflation led to the termination of these and other U.S. import restraints during 1973-74, together with similar liberalizing moves by a number of other countries, industrialized and developing alike. Many people at the time had been worried about a resurgence of protectionism to check imports. However, inflation had become more important than unemployment and was the driving force behind a new wave of unilateral trade liberalization.

2/ United States, Canada, Japan, European Community, Austria, Finland, Norway, Switzerland, Australia, and New Zealand.

Even the historically most protectionist countries, Canada and Australia, unilaterally cut their tariffs across the board. The Australian cut was a full 25 percent. Germany relaxed quotas on imports of textiles and clothing, which had experienced above-average price increases. The United States removed or suspended its import quotas on oil, steel, meat, sugar, and cheese. Japan reduced tariffs on a wide range of industrial imports. Oil-exporting countries such as Iran and Nigeria and developing countries such as Colombia also liberalized imports. Even Italy, the only major country to impose controls in 1974 due to its huge payments deficit, exempted a wide range of products from the outset and started liberalizing the system as soon as it was instituted. Such previously contentious trade issues as the Common Agricultural Policy in Europe, which checks U.S. farm exports, became moot as world prices far exceeded its support levels.

Inflation therefore had at least the one beneficial effect of helping to check protectionism. The exchange rate parity changes of 1971-73 and subsequent shift towards flexible exchange rates also eliminated (or even reversed) most of the earlier balance-of-payments disequilibria, and defused that justification for protectionism. In the United States there was less pressure for general import controls with unemployment above 8 percent in 1975 than with unemployment at 5 percent in 1971, because the dollar devaluations had gone far to restore the international competitiveness of American firms and workers.

This trend was particularly surprising because it occurred during the runup to an expected multilateral trade negotiation in which countries were planning, in the traditional way, to trade off import barriers one against the other on a strictly reciprocal basis. In that kind of environment in the past, countries had always husbanded their existing import barriers to preserve their negotiating position in the coming reciprocal talks. But there was much unilateral reduction of barriers in 1973-75, taking the world another step toward more open trading arrangements.

The calm was disturbed following late 1975 as a number of industrial countries (Britain, France, Japan, Sweden, the European Community as a group) raised new import barriers in sensitive industries, as a result of inadequate recovery from the 1974-75 recession and the failure to adjust to longer-term structural changes. Brazil adopted widespread import controls and export subsidies for balance of payments purposes. The United States subsequently negotiated orderly marketing arrangements for shoes and televisions from major suppliers. U.S. meat import quotas were re-introduced.

New restrictions were concentrated generally on a few manufactured product groups: textiles, clothing, shoes, ships, steel, televisions, and other light engineering products. Imports into Western Europe and North America of these goods from the developing nations and Japan have grown at rates substantially exceeding the expansion of trade in the same products within and between Western Europe and North America. It is thus not surprising that the most frequently used restrictive measures were the bilateral negotiation of voluntary export restraints or orderly marketing arrangements, rather than multilateral import restraints.

Where the United States has entered into OMAs or taken safeguard actions, they have been selective in nature, as emergency actions to avoid further sharp increases in imports of sensitive products, while providing a breathing space for domestic industries to adjust to changing global trade patterns. They have not resulted in actual rollbacks of trade levels, even in textiles, one of the most politically sensitive areas.

The United States has also argued that such arrangements must be temporary in nature, and that they must be coupled with a real effort to adjust domestically. We have sought better international surveillance over the use of these kinds of safeguard measures, and will continue to seek an international safeguards code to assure that safeguard practices are not abused as a new form of protectionism in sensitive sectors.

Complaints of dumping and subsidy practices also led to numerous investigations, culminating in either new antidumping and countervailing duties or the waiver of such duties pending the completion of the Multilateral Trade Negotiations. Although the extensive investigation of such complaints can, if misused, distort trade through the uncertainty they create, the duties actually imposed do not constitute protection per se. Rather, they are defensive rather than offensive measures designed to redress the unfair trade practices of others, and thereby encourage an efficient allocation of resources. I would therefore disagree with IMF statistics which cite the quadrupling of U.S., Canadian, and EC import-restrictive actions, including such duties, from 21 in 1974 to 94 in 1977 as evidence of rising protectionism.

In spite of the strong protectionist pressures which certainly have arisen since 1975 -- and the restraints of a bilateral nature negotiated in certain sectors to safeguard domestic industries from rapid increases in imports -- the Kennedy Round tariff reductions and the major portion of the 1973-74 liberalization have remained intact. Indeed, Japan's Prime Minister Ohira agreed last week to seek Diet approval for using the 1973 unilateral tariff reductions as the new basis for further Japanese tariff reductions in the Multilateral Trade Negotiations (MTN). Improved balance-of-payments positions have also enabled a number of developing nations to liberalize trade restraints. Argentina and Chile have been most notable in this regard. Brazil also announced in early 1979 a decision to phase out by mid-1983 the 100 percent prior deposit required on a variety of imports, as well as its pervasive system of export subsidies which have ranged as high as 40 percent on a number of manufactured products.

<u>Liberalization in the MTN</u>

The recently concluded Multilateral Trade Negotiations have provided the next major step forward in further reducing traditional tariff barriers and regulating government intervention in such areas as subsidies, government procurement, standards, customs valuation, and import licensing:

-- Industrial nations will make tariff cuts averaging more than 30 percent on over $140 billion in trade in coming years.

-- In civil aircraft alone, duties will be eliminated altogether on several billion dollars worth of world trade.

-- Agricultural trade liberalization will benefit some $4 billion in U.S. exports, to say nothing of benefits for other countries.

-- We now have a code setting substantial new rules on the use of subsidies, in the context of which the United States will adopt an injury test in our countervailing duty law.

-- The new government procurement code will open to foreign bidding some $12 billion in U.S. federal purchasing, and some $20 billion in foreign government purchasing, which had not previously been covered by the GATT at all.

-- We have a new code governing valuation of imports for purposes of duty assessment and other codes on standards, licensing, and commercial counterfeiting which will address issues which have increasingly restricted or distorted international trade.

-- Finally, improvements in the GATT Framework will provide a better system for resolving disputes and a better international response to the particular trade problems of developing countries.

The world trading system will clearly register an enormous net gain on the side of fairer and more open trade as a result of these negotiations.

Outlook for the Future

The future outlook for world trade will be governed by a number of factors, not least of which will be our recent success in achieving international agreement to further liberalize world trade. Several problems, however, may yet threaten to undermine this progress:

-- The massive increase in energy costs has yet to work its way through the world economy. The oil price hikes add sharply to oil import bills and thus to trade balance problems, for the United States as well as for most other major nations.

-- Partly as a result of these higher energy costs but partly as a result of other fundamental developments, world growth rates are likely to be significantly lower in the last quarter of the twentieth century than they were during the third quarter.

-- Low growth will mean intensified pressures to export and restrain imports in virtually all countries, in an effort to maintain accustomed levels of employment and production. It also means that some industries are caught with excess capacity, built in anticipation of much more buoyant demand. This is the fundamental problem facing the steel sector in a number of countries.

-- Between 1963 and 1976, the developing countries increased their share of world trade in manufactures from 4.8 percent to 8.2 percent. They will be increasingly formidable competitors across a wide range of manufactured products in the years ahead. They must now be encouraged to take part in the evolving world economy by reducing their own trade barriers.

Under the best of circumstances, it will take many years to adjust to these new conditions. Courageous action will be required of governments, many of whom will not be in strong positions to act decisively. Electorates will, understandably, resist the real hardships which may frequently be required when adjustments are undertaken. Even a return to much fuller employment would probably not eliminate the pressures to restrain trade in this country, as indeed it did not at the turn of this decade.

These adjustments do work -- witness the sharply improved conditions in Italy, Britain, Mexico and Brazil -- if undertaken with deliberation and determination. Indeed, they are essential for the future health of both the national economies involved and the world economy as a whole. I am confident that they will eventually be adopted, and carried through to successful conclusion; there is simply no other way. But there will be continued temptations, in a world of growing international interdependence, to try to avoid or at least defer the needed internal measures by exporting the problem to someone else.

Protectionism will continue to present a challenge to all nations. I am optimistic, however, that the trend is still on the right track. With strong enforcement of the new MTN agreements and continued efforts to resolve problems in specific sectors through mutual cooperation, I believe that we can maintain and further improve the liberal world trading system in the decade ahead.

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May 9, 1979

JOSEPH LAITIN
ASSISTANT SECRETARY (PUBLIC AFFAIRS)

Joseph Laitin was nominated as Assistant Secretary of the Treasury for Public Affairs by President Carter on March 31, 1977, confirmed by the Senate on April 29, and sworn in by Secretary W. Michael Blumenthal.

As Assistant Secretary, Mr. Laitin is responsible for the public affairs activities of the Secretary and management of all the public affairs policies, plans and programs of the Treasury Department. He served in similar capacity as Assistant Secretary of Defense in 1975, and was awarded the Medal for Distinquished Public Service by the Department of Defense.

Before joining the Treasury Department, Mr. Laitin was with the Federal Aviation Administration, where he was Assistant Administrator for Public Affairs and Director of Information Services.

From 1963 to 1975, Mr. Laitin was Assistant to the Director of the Office of Management and Budget in the Executive Office of the President. In 1965-1966 he was on detail to the White House as Deputy Press Secretary to the President.

During the time Mr. Laitin was at the Office of Management and Budget (prior to 1970, known as the Bureau of the Budget) he served on the staff of various Presidential Commissions, including the National Commission on the Causes and Prevention of Violence, Campus Unrest Commission and the Selective Service Commission.

From 1953 to 1963, Mr. Laitin was a free lance writer, his articles appearing in numerous national magazines. During this 10-year period of self-employment, he was an instructor at the Art Center School in Los Angeles and broadcasted regularly for the CBS and ABC networks as a commentator and reporter. He wrote, narrated and produced for CBS radio the award-winning documentary "The Changing Face of Hollywood."

Before going to Hollywood, Mr. Laitin was Chief Correspondent for the Research Institute of America in Washington, D.C. from 1950 to 1952. Mr. Laitin was with the Brooklyn Daily Eagle and the Standard News Association before World War II. During the War, he was head of the United Press economic staff in Washington, D.C., later went to the Pacific Theater as a war correspondent for Reuters. He covered the Japanese surrender on the USS Missouri, the occupation of Japan and Korea, the war crimes trials in Manila, then the Bikini atomic tests. He later reported on the closing weeks of the Nuremberg trial and then covered some of the trouble spots in the Carribbean and Latin America.

A native of Brooklyn, New York, Mr. Laitin and his wife, the former Christine Houdayer of Paris, have two children and reside in Bethesda, Maryland.

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IMMEDIATE RELEASE
May 10, 1979

Contact: Charles Arnold
202/566-2041

PRESIDENT CARTER APPROVES
INCREASE IN SAVINGS BOND INTEREST RATE

Secretary of the Treasury W. Michael Blumenthal today announced that President Carter has approved an increase in the interest rate paid by the Government on Series E and H savings bonds. Bonds issued on and after June 1 will receive 6-1/2% if held to maturity, which will remain at 5 years for E bonds and 10 years for H bonds. The current interest rate is 6%.

The annual interest rate on outstanding E and H bonds and U.S. Savings Notes (Freedom Shares) for the remaining period to their next maturity will also be increased by 1/2%. The improved rate will be effective for bonds and notes which begin a semiannual interest period on and after June 1.

The interest rate increase will benefit the holders of about $81 billion in outstanding savings bonds and notes. No action on their part is necessary to take advantage of the higher rate.

The rate on the recently announced Series EE and HH bonds, which will go on sale in January 1980, will also be increased to 6-1/2%.

Azie Taylor Morton, Director of the U.S. Savings Bonds Division and Treasurer of the United States, said that the 6-1/2% interest rate, coupled with the tax advantages available to savings bond owners, represents a fair return and makes the bonds more attractive as a long-term investment.

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FOR RELEASE ON DELIVERY
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REMARKS BY THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE
THE BUSINESS COUNCIL
HOT SPRINGS, VIRGINIA
MAY 11, 1979

Once again, the energy issue has moved to the center of American politics.

This has happened periodically -- every few months or so -- since the Arab oil embargo of 1973.

Two things strike me as remarkable about this long and rather turbulent history of political debate about energy.

This first is that the pace and intensity of the political rhetoric has been so infrequently matched by action. We have become great talkers about energy. But until the last year or so, the government has done very little constructive about the problem. Until President Carter moved energy to the top of the nation's agenda in the spring of 1977, most of the key issues were locked in stalemate.

The second curiosity is that, despite all the passionate political talk about energy, a majority of Americans -- or so the polls say -- continue to doubt that our energy problems are real and serious. The preferred view, apparently, is that the crisis is merely an artifact of some undefined conspiracy between the government, big business, and the media. The energy crisis emerged contemporaneously with the deceptions of Watergate, and during the waning months of the Vietnam War. The sour suspicions of that period have trailed along after the energy issue even since.

At any rate, these two phenomena -- government in - action and public apathy -- have fed upon each other over the years, making it formidably difficult for us to deal intelligently with the underlying issues.

B-1592

We cannot afford this any longer. It is critical that the American people understand that the energy crisis strikes to the core of this nation's political and economic security.

The key to the immediate problem is crude oil -- its cost and availability. The story can be told by a few numbers. In 1970, the posted price of light Saudi Arabian crude, the chief indicator of world oil prices, was $1.60 per barrel. Today the posted price is $14.54, an increase of 708 percent. In 1970, the U.S. met 76.7 percent of its crude oil needs out of its own production. Today, we meet only 50 percent of our needs from our own production, despite gains from Alaska, and our import bill is now running at a rate of $50 billion per year. In 1970, 72.7 percent of our oil imports were supplied by Western Hemisphere nations (primarily Canada and Venezuela). Today, less than 20 percent of our imports come from these countries.

Three times over the past 21 years -- in 1958, 1975, and 1979 -- senior economic policy officials have examined whether our national security is threatened by the volume and character of our oil imports. In each case the answer has been: Yes!

The national security elements are clear:

- Because so much of the oil we use comes from thousands of miles away, supplies are vulnerable to interruption.

- Increasing reliance on uncertain foreign sources of oil puts at risk the independence and vigor of our foreign policy.

- As our oil import bills have skyrocketed, our export growth has not been sufficient to balance our trade accounts. Large trade deficits have been the result. This puts downward pressure on the dollar, and dollar depreciation can be extremely harmful to the American people, increasing domestic inflation and eroding real incomes. Excessive depreciation also hurts the entire world economy, for a stable dollar remains essential to world trade and finance.

- Cartel control of over 50 percent of the world's oil supply exacts an increasing drain on the real resources of all the consuming nations, and subjects their anti-inflation plans to unpredictable shocks. Our increasing oil imports play into the hands of the world oil cartel, adding to upward pressures on world oil prices. This is no small factor: Our oil imports today constitute 17 percent of world oil production.

- Finally, as escalating U.S. oil imports suggest, this country is not yet making a determined and creative transition to a world in which oil supplies are scarce, expensive, and often unreliable. We are continuing to use energy, and particularly oil, at a far too lavish rate, and we are failing to make those long-term investments in alternate energy technologies that will be essential to our economic and political security in the remaining years of this century.

To extricate ourselves from all this requires unusual courage and foresight by our political leadership. I believe the President has met that test.

In running for the Presidency, Jimmy Carter put energy issues near the center of his campaign. Upon assuming office, he moved energy to the top of the nation's agenda. In a deliberate, and remarkably selfless, act of political leadership, he expended the normal popularity of the so-called "honeymoon" to wrestle through the Congress a major reorientation of our energy policies.

The National Energy Act, passed last year, took major strides in breaking a decades - long political deadlock on natural gas pricing. But, despite the President's best efforts, the Congress refused to resolve the central issue of oil pricing policy.

By failing to act, the Congress left in place great economic deception: The system of oil price controls and entitlements that have entangled our energy policy in monumental redtape for 8 years.

This system of controls and entitlements is one reason that the American people have not been able to grasp the realities of the energy crisis. For the system has been telling consumers and investors that oil is cheaper than in fact it is.

The effects of the controls system have not been trivial. To take one example: In February of this year, as the Iranian crisis was unfolding, our domestic price controls-and-entitlements program was providing to our oil refiners and consumers an effective subsidy of $2.56 per barrel to import oil, rather than to develop and use domestic energy sources. That subsidy was more -- substantially more -- than the price of a barrel of oil at the start of this decade.

Consider what that means. On the verge of a dangerous and impredictable world oil shortage, resulting from foreign political upheavals beyond our influence, our energy laws were working to stimulate oil imports, to promote oil consumption, and to discourage domestic oil production.

There was a time, perhaps, when this nation could afford to neglect its interests in this giddy fashion. That time has passed.

This spring, once again, as in the spring of 1977, President Carter has put the vital national interest in a sound energy policy very much ahead of his personal political interests.

The President has mandated an orderly, but decisive and complete, dismantling of the oil price controls and entitlements system. The job will be complete by October 1981.

A system that now requires, for its daily operation, thousands of bureaucrats and volume after volume of impenetrable regulations, rulings, and exceptions will be put at last behind us. Eight years of highly divisive political stalemate on oil policy will have been brought to an end. For the first time in a decade, prices will tell Americans, accurately, what it actually costs them to buy oil on world markets. Better than any conceivable government program, or any number of ringing speeches, this simple step will bring forth from the American economy a genuine inventiveness in conservation methods and in new energy technologies.

Along with decontrol, the President has proposed a tax on the windfall profits accruing to U.S. oil producers both from the decontrol itself and from future real increases in

OPEC prices. The proceeds of this tax will form an Energy Security Fund, to help finance new energy technologies, to cushion the impact on the poor, and to promote mass transit.

As he fully expected, the President's program has faced a great deal of emotional opposition, from different points of view.

On one side, decontrol is anathema. In my view, the arguments reveal a tenuous grasp of basic economics. The arguments imply that oil -- unlike any other good or service -- is virtually insensitive to price, and thus that decontrol will yield negligible conservation and supply efforts. The evidence is overwhelmingly to the contrary. U.S. energy use per dollar of real GNP has fallen from 62 thousand BTU's to 56 thousand over the past eight years, very substantially as a result of a rational adaption to rising energy prices. And one need look only to the recent enlargement of natural gas supplies, and the shortages of unleaded gasoline, to see the effects of price incentives and disincentives on the availablity of hydrocarbon energy. Similarly, the production of so-called "old" oil has, over the past 5 years, varied sharply with the price incentives allowed under the controls system.

Critics of deregulation believe that the controls in some sense "protect" American consumers from OPEC. This is akin to the protection afforded an ostrich when he submerges his head in the sand. The controls on domestic oil prices do not make the OPEC oil we import any cheaper. They make it <u>more</u> expensive -- by increasing our import demand for it and by depressing the international value of the dollar.

On the other side, by contrast, the criticism of our program has focused on the windfall profits tax.

I expect that some of you have misgivings about that tax. Let me try to meet those concerns.

This tax is well designed and makes eminent good sense from an economic point of view.

The tax does <u>in fact</u> aim at windfalls -- not at those increases in profit that are necessary to stimulate domestic oil production.

I think you will agree that, in a decontrolled domestic oil market, some of the profits of U.S. producers will indeed be windfalls -- in the straightforward sense that actual profits will exceed the amounts required to stimulate very rapid investment and production. This is largely because the price of oil is set by a cartel of governments, not by a normal competitive market. This is a sound reason to capture a portion of domestic profits for public purposes. Other oil producing nations have recognized this, and have imposed a special tax or some parallal mechanism on domestic oil profits.

The tax proposed by the President is skillfully drafted to preserve the production incentives provided by decontrol itself. I will not take your time with a detailed analysis of all the provisions, but a few points deserve mention.

This is not a confiscatory tax. It is a 50 percent tax, applied per barrel, on the inflation-adjusted extra revenues that arise from decontrol and from future OPEC price increases. The tax has a genuine bite, but it is not extreme: Without the tax, producers would receive 43 cents net from each dollar in increased revenues. With the tax, they will receive 29 cents from each dollar. Depending on the future course of OPEC prices, the tax will reduce by 30 to 45 percent the amount of money the industry would keep as a result of decontrol.

At every point, the tax has been crafted to avoid stifling production:

- The base of the tax is adjusted for inflation, which provides for recoupment of increased costs.

- High cost oil, such as that from marginal wells and the Alaska North Slope, receives carefully defined exceptions.

- The tax on so-called old oil encourages a maximum outflow of oil from existing wells.

- The only permanent part of the tax is that which assures an equitable sharing by the public in future OPEC price increases.

Some in the oil industry have suggested that the tax should be offset to the extent oil companies invest their profits in new production. This seemingly plausible idea --

which goes under the name of "plowback" -- should get a skeptical reception from the rest of the business community. It would amount to a special subsidy only for existing owners of oil properties to invest in oil production. This would introduce an unhealthy discrimination against new entrants. A plowback provision would also render the tax subject to abuse and infinitely more complicated. And it is simply not needed. The tax itself preserves high profit incentives for investment in new production. A special gimmick simply to increase the cash flow of existing oil owners would not spur production and would turn the tax itself into a sham.

The proceeds of this new tax will be well spent, spent -- I believe -- more productively than if the revenues were left, as unnecessary windfalls, with the oil companies. The proceeds will flow into an Energy Security Fund, with three broad purposes. First, the Fund will help cushion the devastating impact of rising energy prices on the poor. Second, the Fund will promote a necessary shift to energy-efficient mass transit. Third, the Fund will help subsidize the development of new energy technologies which the private sector can bring forward rapidly only with an initial boost from the government.

This brings me to a larger point, on which I would like to conclude.

The President's program sets a sweeping new direction for U.S. energy policy. The program recognizes that this country needs the initiative, inventiveness, and expertise of private business to pull us out of the energy crisis. Government's job is to correct inequities that may arise -- to ensure fairness -- without in the process derailing the whole enterprise, and also to provide assistance on these frontiers of energy technology where economic uncertainties occasionally hold back private sector progress essential to the public interest.

But the main task is to get unnecessary government regulation out of the way of private sector progress.

We have found -- and that is my larger message -- that this is often the main task, in many areas of policy. The President has pursued it with courage and consistency across the whole spectrum of economic policy.

It is not only energy prices that the President has decontrolled. He has pushed also for substantial deregulation in the airline, railroad, trucking, and commications industries. And he has taken unprecedented steps to bring economic rationality, and simple common sense, to bear in weighing the costs and benefits of regulation in the health, safety, and environmental areas.

Along the same lines, the President has exerted continuous, item-by-item pressure to restrain government spending, to move us toward a balanced budget, and thereby to prune back the government's share of our financial and real resources.

This broadbased effort to contain the spending and regulatory appetites of the bureaucracy has come at a very high political cost for the President. This was not unexpected. The President has pursued this hard struggle, because, he is convinced that this is the only way to revive the productivity and strength of this economy.

The results of these efforts will not show up quickly. The long-term interests of the economy do not respond to the political exigencies of an election cycle.

Washington, which lives by that cycle, expects that at any minute the Administration will, like many of his predecessors, throw aside its concern for the nation's long-term future and relapse into the familiar scenario of wage and price controls and uninhibited public spending.

Those betting on that scenario do not know this President.

But I will not belabor the point. Let me note simply that this decision on oil price decontrol was the most closely examined and debated issue in the Administration's two year history. It was seen by all of us as a watershed decision, with implications across the whole sweep of economic policy. The President has set his energy course by the compass of sound, market-oriented economics -- and that compass will guide us across the entire landscape of economic policy.

We need your help to hold our course. It is in your interest, and that of the nation, to stand behind a President with the courage to look beyond short-term politics to the real economic interests of the nation.

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For Release on Delivery

Remarks of the Honorable Anthony M. Solomon
Under Secretary of the Treasury for Monetary Affairs
before the
National Journal
International Trade and Investment Conference
May 11, 1979, 9:00 A.M.

You have asked "will the current international monetary system serve the future international trade and investment environment."

My answer is -- in the short run -- "yes", fundamental changes have been introduced in recent years which give us more workable monetary and credit arrangements. But in the longer run, the present system will not necessarily meet future needs. The international monetary system is undergoing, and must undergo, continuous evolution to adapt to changing conditions. Several important -- and related -- lines of evolution are now under consideration, responding to concerns about the current system. I would mention three such concerns:

First is a cluster of concerns about the operations of the international banking and credit system, and particularly the Euro-currency market. Does it provide adequate credit, or too much? Is it aiding international adjustment or retarding it? Is the market adequately supervised, or is there a risk of imprudent banking practices?

Second is a concern that the large stock of dollars in foreign hands, private and official, is destabilizing, and that the international role of the dollar should be reduced in the future in order to achieve greater stability in the international monetary system.

Third, and in my judgment most important, is a concern that our arrangements for international coordination of economic policy may not keep up with the demands of an increasingly interdependent world.

International Banking

The marked expansion of the Euro-currency market in recent years is often viewed with awe and apprehension. Some favor greater official action to bring the market under tighter control. In fact, the degree of official attention given this market in recent years, and the degree of supervision and regulation that actually exists, are much greater than generally realized. Whether or not there is a case for further measures, we should understand the major shifts that have occurred in the world's needs for financing, and what the role of the Euro-currency market has been.

In the early 1960's, payments imbalances among nations were relatively small, with the developed countries as a group running modest current account surpluses, transferring net real resources to the developing countries, whose deficits were largely financed by grants and loans of official development assistance, or by private direct investment.

In the latter half of the 1960's, the U.S. balance of payments came under strain, because of reduced current account surpluses and large capital outflows. In part, these capital outflows took the form of direct investment -- as American firms sought to maintain markets abroad by producing there. Also, foreign governments and their citizens borrowed more in our markets, to expand consumption and investment. Eventually, to maintain the dollar's par value and the system of gold convertibility, the U.S. imposed capital controls to deter lending by U.S. residents and to encourage American firms to borrow abroad, thus reducing the net capital outflow and resulting pressure on the dollar.

These controls gave a tremendous boost to the development of offshore money markets -- the use of dollars by non-residents for meeting the rising world demand for credit. Other national markets were either too thin and undeveloped or, like those in the U.K., imprisoned by controls. The international financial market that emerged -- the Euro-currency market -- became so efficient that even when the U.S. controls were removed, it could compete effectively both in bidding for deposits and in extending loans. Rather than withering away, it flourished.

In part, the comparative advantages of the Euromarket are attributable to clear financial incentives. There are no reserve requirements, no interest rate ceilings, and no credit controls. In some cases, tax considerations favor doing business in the Euromarket rather than domestic markets. But other factors are equally important in explaining the market's attraction and vigor: it has proven extraordinarily innovative in developing new financial instruments to meet its customers' needs; it has provided a focal point for intense competition among the leading banks from each of a number of national banking systems; and it has offered insulation from various political risks, or at least an opportunity to diversify those risks internationally.

The growth of the market has given rise to a persistent debate: whether it is an engine of excessive credit creation which aggravates world inflation, or essentially a highly efficient intermediary reallocating funds from lenders to borrowers. Certainly, a large part of new international lending has been channeled through the Eruomarket because of its attractions. Despite its growth, Euromarket credit to final borrowers is still only a fraction of total funds raised in domestic banking markets -- in the case of dollar credit, on the order of 15 percent over the 1974-78 period. But it is a growing fraction, and its relation to domestic and international money and credit flows needs to be carefully assessed.

The growth of international banking activity has been due not solely or mainly to the existence of the Euromarket but to vastly increased international credit needs. In recent years, and particularly since the oil price quadrupled in 1974, the size of the aggregate current account imbalances which the system must finance has risen dramatically. Aggregate current account deficits rose from an annual average of $15 billion in 1971-73 to an average during 1974-78 of $80 billion annually -- a total of $400 billion in five years.

Countries facing these sharply higher deficits needed credit on an unprecedented scale. Without such credit, they would have been forced to reduce their external deficits by imposing extremely severe restrictions on domestic demand, or resorting to aggressive trade and exchange rate behavior. Until last year, the OPEC surplus countries provided most of that credit, and the international banking system served as the intermediary.

Some contend that the Euromarket went too far -- that it made credit too readily available and thus fostered excess liquidity, excess demand and inflation. However, the role of the Euromarket has been essentially that of an intermediary and to a considerable extent borrowers and depositors would have moved to national markets in the absence of the Euromarket. Moreover, there was a genuine need for this credit, and I do not believe that the world economy would have been better served had the volume of credit been substantially less. Even with the amount of credit that was in fact available, the world experienced its worst recession in decades, and recovery, for many nations, has been agonizingly slow.

Some individual countries have, of course, faced difficulty servicing their increased external debts. Some neared the limits of their capacity to borrow very quickly and were then compelled to step on the brakes too hard. This poses difficult problems for the countries and lenders concerned, and such experiences will undoubtedly have a moderating influence on both borrowers and lenders in the future. But it is not clear that <u>general</u> controls on the Euro-currency market, even if effective in reducing global credit expansion significantly, would be an appropriate response to what in practice has been a very <u>selective</u> and specific problem.

In the past year or so the pattern of international financing has changed, with the shift of the U.K., Italy, and France into current account surplus; the reduction of the U.S. current account deficit; the decline in Japan's surplus; and the dramatic decline in the OPEC surplus to less than $5 billion in 1978 as a whole and near zero in the second half of the year.

Unfortunately, the near-elimination of the OPEC surplus last year was short-lived. The recent oil price decisions, and reduced growth in OPEC import demand, are producing a new and sharp increase in the surplus. Assuming that the international credit mechanism continues to function, and that oil importing countries are not forced to curtail domestic demand dramatically, the OPEC surplus will rise to $25-$30 billion in 1979 and more in 1980 -- much more if there are further significant increases in the price of oil. Even if the Japanese surplus continues to decline substantially and there is some reduction in the surpluses of other countries such as Germany and Switzerland, world current account deficits are likely to total something on the order of $80 billion in 1979 and possibly more in 1980, very large deficits indeed.

We must anticipate continued growth of international credit -- growth on a very large scale -- until these large current account imbalances can be reduced. Official financing must be adequate to meet critical needs but will not -- and should not -- meet the bulk of the financing need. That will be provided by the private markets. The private markets will have to account for perhaps three-fourths of the total financing needs, on the basis of the past trends. Thus we must expect the size of these markets to continue to expand.

The economic problem is to allocate funds from surplus to deficit countries. But in the process we must be sure that these flows do not overburden the financial institutions or threaten the banking system generally. The prospect of continuing growth makes it all the more important that national authorities have adequate information and exercise adequate control and surveillance over the operations of banks in the market.

In recent years, the U.S. banking authorities -- the Comptroller of the Currency, the Federal Reserve, and the FDIC -- have taken a number of steps to improve the supervision of foreign lending by U.S. banks -- including the operations of their branches in the Euromarket. The new approach is designed to promote appropriate diversification of bank portfolios and to avoid excessive concentration of lending relative to a bank's capital position. Special attention is given to bank management procedures for assessing risk and controlling exposure. To support these efforts, new, comprehensive reports are being collected from each U.S. bank doing business internationally. The information provided shows a bank's exposure to each country abroad, with detailed breakdowns by type of customer, type of loan, and maturity. The reporting system gives bank examiners a uniform basis for reviewing in detail a bank's internal loan and deposit records. The approach is complemented by onsight inspection at U.S. banks' overseas branches. Above all, the supervisory system emphasizes the continuing need for banks to take account of changes in economic conditions in countries abroad in formulating their lending policies. To be sure, no supervisory approach can guarantee that there will never be a problem with a particular loan. But the emphasis on strong management controls and adequate diversification should limit potential adverse effects on the banking system as a whole.

The need for improved supervision has been recognized by a number of countries, and many have felt that a cooperative international approach could reinforce their own domestic efforts. There has been a significant expansion in the amount of information collected through the Bank for International Settlements, and new efforts are underway. The central banks of all major countries meet regularly through the BIS, at the policy level and the technical level, to exchange views on Euromarket developments and to discuss supervisory techniques. These efforts are being strengthened.

Nonetheless, we reocgnize that the Euromarket represents a global system, and that the participants in that market manage their positions from a global perspective. These markets inevitably interact with domestic money and credit markets. Therefore, we should consider whether additional measures are needed to help assure that the Euromarkets do not work to erode domestic money and credit policies, and that the markets themselves remain strong and capable of fulfilling their intermediary function. A variety of instruments -- for example, introduction of a minimum reserve requirement on Euro-currency deposits -- could be considered that would make a contribution to the strength and stability of the Euromarket, and to the greater effectiveness of national and international monetary policies. This is an area that deserves careful attention in the period ahead. In the meantime, the U.S. will continue to work to assure that there is adequate information about the Euro-currency markets and supervision necessary to insure that the markets operate prudently.

International Role of the Dollar

The second area of concern -- the international role of the dollar -- is related very closely to the concern about international credit. The bulk of Euromarket activity, and the bulk of private and official borrowing, lending and reserve accumulation, takes the form of dollars. As these magnitudes have grown by scale factors in recent years, so also has the volume of dollars held by non-U.S. residents, whether in the form of claims on the United States or dollar claims on the Euromarket.

The concern is whether the existence of large dollar balances constitutes an important source of instability in the international monetary system. Particularly in the light of the exchange market instability of recent years and the heightened perception that external developments do make a difference to the United States, this concern has given rise to various proposals -- for funding or consolidating foreign official dollar holdings, for increasing the role of the SDR in the system, and for placing greater reliance on other currencies, such as the Deutsche mark and the Japanese yen, in international financial transactions and reserves.

It is clear that sudden shifts in ownership of dollar balances can and sometimes do add importantly to pressures and instability in the exchange markets. But there is substantial question whether the existence of large foreign-held balances is the major part of the problem that has affected the dollar. The period of dollar instability prior to last November 1 undoubtedly was rooted in questions about our underlying economic policies, performance and outlook; questions about our will in mounting a coherent and effective attack on problems of energy and inflation. There was during that period some diversification by foreigners out of dollar holdings -- mainly private but to some extent official. But that experience also reaffirmed what we already knew -- that there is enormous scope for capital movements and changes in the timing of payments by American residents, leading to exchange market pressures quite independent of an existing stock of foreign dollar balances. The experience since November 1 -- involving large reflows into dollars -- has taught that same lesson in reverse. Thus while moves to reduce the international role of the dollar, particularly the reserve role, may have some positive impact on market perceptions and behavior, I do not believe this approach can get at the root cause of exchange market problems.

Consequently, the effort to strengthen the role of the SDR -- and as part of that effort, discussion of a possible substitution account in the IMF -- should be seen as part of a long-term evolution of the system, an evolution which holds out an ultimate prospect of greater order and stability, but which is not directed to the immediate market situation.

I should stress that in this examination of structural changes in the international monetary system, the U.S. objective is not to perpetuate a particular international role for the dollar. The dollar's present role is itself the product of an evolutionary process -- a process that will continue, and that may bring a reduction in the dollar's relative role in the future. Indeed, some of the main factors in the evolution of the dollar's role would appear to suggest some gradual reduction.

First, the relative size of the U.S. economy has declined substantially over the past two decades, from about 30 percent of the world's GNP in 1960 to about 23 percent in 1978. I would expect the trend to continue to some extent during the 1980's, as developing nations continue to grow faster than the world's average, and the spread of technology enables other nations to move closer to the high levels of production and living standards enjoyed by the United States.

Second, foreign capital markets have also expanded relative to that of the United States In 1964, the U.S. capital market provided roughly $80 billion of net new credit, as compared with less than half that amount in Japan and Germany combined. By 1977, the figures had grown to about $400 billion in the U.S., as compared with about $250 billion in Japan and Germany. During the 1960's, no market other than the U.S. could have handled issues of the size needed by major international borrowers, some of which exceeded $100 million. That is no longer the case. As an example, the U.S. Treasury raised almost $3 billion on the German market in a three-month period following the November 1 announcement.

But against these developments, the openness of the U.S. market is not duplicated in other major countries. Most maintain restrictions of one kind or another, applied with varying degrees of severity.

Thus, while there have been significant changes in the relative size of the U.S. economy and capital market, these have not been paralleled fully by opening of foreign money and capital markets. Yet it seems to me that this last condition must be fulfilled if there is to be a significant reduction in the dollar's international role. The SDR offers potential for assuming a larger role in official reserves -- and perhaps, in time, a role in private transactions. But given the large volume of international credit that will be needed in coming years, a reduction in the role of the dollar in practical terms implies willingness of other countries to open their money and capital markets, to match their heavier weight in the international economic system. Some progress has been and is being made. More is needed.

Economic Policy Coordination

The third major area of concern -- in my view the most fundamental and most important one -- is whether and how quickly the international community can bring itself to coordinate economic policies more effectively, to reduce inflation rates and inflation differentials and to manage domestic growth rates so as to bring about a better balance in global economic relations.

I do not believe that the instabilities and tensions of recent years can realistically be ascribed in an important way to defects in our international monetary arrangements per se. They are more deeply rooted in the massive move toward interdependence that has characterized the past three decades. Progressive trade liberalization and heightened access to international capital brought unparalleled progress to the world economy. But as part of this process, national economies became much more intertwined. The industrial and agricultural structures of the advanced nations are now highly dependent on foreign sources and foreign outlets. Trade flows, now greatly liberalized, respond more quickly and more powerfully to changes in incentives. Owners of capital have become much more sensitive to opportunities to move money across national boundaries and freer to do so. Exchange rates, and the international monetary system more generally, have become subject to much more immediate responses to disparities that develop in national economic performance.

In short, the benefits of greater interdependence have come at the price of greater exposure and vulnerability to events elsewhere in the world. One practical implication of greater interdependence is greater constraint on national policy formulation. Today all governments are constrained to take account of the effects of their policies on others; to factor external developments into domestic policy formulation; and to maintain consistency between their international economic objectives and their domestic economic performance.

Such constraints have never been entirely absent. But with the changes we have witnessed in the world economic structure over the past three decades, they have become more severe and more difficult to ignore. There is broad international understanding of the meaning and implications of interdependence, not only on an intellectual level but to some extent in practice. We have over the years developed a variety of organizations to facilitate international cooperation in many fields. The OECD has served as a forum for discussion among the industrial countries of economic policies and balance of payments developments. The IMF has traditionally consulted with member countries on broad economic policies, and has been given important new potential for expression of policy advice. The economic summits have opened a new range of possibilities for coordination at the highest level among the largest countries.

But we are still trying to work out the right organizational framework for international coordination of national economic policy -- and to make such coordination meaningful in translating international consensus into domestic action.

We all face the imperative of cooperating and coordinating to deal with the pressures of interdependence. The key question is whether we can deal with these pressures in a constructive and mutually beneficial way -- whether our ability to manage meaningful domestic policy coordination on the part of sovereign governments will keep up with the strains arising from our increased interdependence. Evolution of the IMF's surveillance role will provide a test. The IMF has been given potentially important powers of surveillance and advice not only over member countries' exchange arrangements, but over their domestic economic policies as those policies relate to the international adjustment process. These provisions afford a framework that can be developed to provide a practical vehicle for policy coordination -- if governments are prepared to give the Fund the necessary power and influence.

Conclusion

I began this talk by referring to the question posed by the organizers of this conference: whether the current international monetary system will serve the future international trade and investment environment. I believe that our international financial and monetary arrangements should and will evolve, and our effort will be to see that they evolve in a direction that is compatible with and supportive of a liberal world trade and investment system. The current period of relative monetary stability provides both a basis for confidence and breathing space for unhurried consideration of ways to strengthen our monetary arrangements. But the key question goes well beyond improvements in our monetary arrangements -- it is the need for governments to improve international economic policy coordination, in recognition of their self-interest in preserving our interdependent system. Meeting that need is central to the maintenance of an open and liberal trade and investment environment for the future, and it must be the focal point of our efforts.

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REMARKS BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SECOND ANNUAL CONFERENCE ON INTERNATIONAL TRADE
AND INVESTMENT POLICY
OF THE NATIONAL JOURNAL
WASHINGTON, D.C.

THE NEED FOR INTERNATIONAL COOPERATION IN THE INTERNATIONAL INVESTMENT AREA

U.S. Policy

U.S. policy with respect to international investment is based on the premise that the total benefits from international investment are maximized if governments seek to take no actions either to accelerate or hinder investment flows into or out of their national territories.

We believe that intervention into investment by home or host national governments may distort the efficient allocation of economic resources and thereby reduce the gains from international specialization of industrial output and the resulting gains from trade. Moreover, efforts by one government to tilt the benefits of international investment in its direction through interventionist policies are likely to prompt countermeasures by other governments, with additional adverse effects on world economic welfare and on overall international relationships. These effects are similar to those created by tariff and nontariff barriers to trade, export subsidies, and competitive depreciation of a currency.

Hence the United States policy toward international investment contains four important elements:

(1) the Government should neither promote nor discourage inward or outward investment flows or activities;

(2) the Government should avoid measures which would give special incentives or disincentives to specific investment flows or activities;

(3) the Government should avoid intervention in the activities of individual companies regarding their international investment; and

(4) the Government views investment flows to developing countries to be a matter of particular concern.

The Nature of the Problem

This policy is tempered by the realities of today's world. It is clear that many governments actively intervene in the investment process in an effort to garner benefits for their national economies. Indeed, many state and local governments within the United States, and occasionally our own Federal Government, have made such efforts.

Such intervention takes many forms, but it can combine the use of investment incentives and performance requirements. Incentives are generally used to influence the locational decisions of individual firms. Performance requirements are imposed upon firms to ensure that they contribute to the priority economic and social goals of the host government. These usually focus on local job creation, transfer of technology to the local economy and expansion of local value added and export levels.

These interventionist policies rest on an increasing commitment to growth of new capital formation, a commitment which the U.S. Government shares with other governments. Coordinated international action to spur new capital formation is a highly laudable objective, one which most countries are pursuing.

What is troublesome, however, are some of the ways in which governments are carrying out this objective. Rather than adopting generalized approaches which will increase total capital formation, governments often adopt industry-specific, or even firm-specific, measures which may only serve to redistribute existing investment or divert to a different location investment that would have been made in any event.

The recent Canadian offer of $68 million to the Ford Motor Company to build a plant in Ontario instead of Ohio is a case in point. So is the British enticement of Hoffman-LaRoche, the giant Swiss pharmaceutical firm, to locate operations in Britain with an incentive package approaching $100 million. France this year offered the Ford Motor Company an incentive package valued at a reported $400 million to locate an automotive assembly plant in Alsace-Lorraine, although the deal has apparently fallen through. Advanced developing countries, such as Brazil and Mexico, require foreign companies to produce locally up to 100 percent of the value-added as a condition of participation in their automobile industries -- performance requirements which are equivalent to zero import quotas on parts and other imports and which are relaxed if and only if the companies expand their exports. Investment incentives and performance requirements such as these have the effect of shifting the location and benefits of investment across national borders, thereby, in essence, exporting one country's problem to another.

If these measures continue to proliferate, conflicts between governments may develop. This would especially be the case if the world economy were to go into severe recession, and nations were to use investment incentives and performance requirements as a means to try to transfer the resulting unemployment in their economies to other nations. Under a floating exchange rate regime, the resulting inflows might cause the offending nation's currency to appreciate and thus to reduce its attractiveness as a place to invest. At its worst, a spiral of beggar-thy-neighbor competition might develop, where intervention by one government could stimulate emulative countermeasures by others to the detriment of all. We believe that no crisis of this nature will develop if we can develop a broad consensus on an international economic system permitting investment to flow across national boundaries according to economic forces.

A major objective of U.S. policy, therefore, is to achieve increased multilateral discipline on incentives and other interventions, both to maintain an open investment environment and to avoid emulative countermeasures. The 1976 OECD Declaration of International Investment and Multinational Enterprises and related decisions deal with aspects of the problem and represent an initial multilateral effort at strengthening multilateral discipline and increasing international cooperation on investment issues. Bilateral investment treaties and treaties of friendship, commerce, and navigation deal with some aspects of the investment relationship. None of these, however, constitutes more than a start at achieving international cooperation in this area. International trade and monetary affairs, by contrast, are governed by long-standing rules and institutional arrangements embodied in the GATT, in bilateral treaties, and in the Articles of Agreement of the International Monetary Fund. Major improvements in the trading rules have just been accomplished in the Multilateral Trade Negotiations. We believe that similar cooperation on international investment should remain a priority item on the international economic agenda.

The development of a basis for multilateral cooperation with respect to international investment has thus become an important part of U.S. international economic policy. We face a basic problem, however, in trying to achieve cooperation in that most governments have not yet recognized the need for increased international cooperation to maintain open principles regarding international investment. In part, this is because direct investment has become a major vehicle for international economic exchange only in the last twenty years or so, and its impact upon the international economy has thus not been visible for as long a time as the impact of trade flows and exchange rate changes.

A similar ambivalence exists within the United States. Many of our own laws, regulations, and policies affecting international investment and multinational firms have been carried out unilaterally, without full consideration of their international dimensions. Our own states and localities often extend incentives which attract investors from abroad as well as domestic investors. I have recently discussed this issue in meetings with representatives of state and local governments, under the auspices of the Advisory Commission on Intergovernmental Relations. The Commission is now studying the interaction between such internal U.S. actions and the international investment process, as part of its broader analysis of relations among the states themselves regarding investment policies. Similar sub-national issues regarding international investment policy also arise in other countries with federal government systems, such as Canada.

Unaddressed, the underlying problems resulting from governments' use of incentives and performance requirements will likely get worse simply by virtue of the growing volume of international investment. The large firms of Japan and Europe increasingly are extending their investment activities into foreign lands along with their U.S. rivals. Some of the more advanced developing countries (e.g., Brazil, Mexico, Taiwan, Korea) have become hosts to foreign investment on a large scale. In addition, some large firms based in these rapidly industrializing nations have themselves become multinational, and hence several of these nations are now home as well as host to foreign direct investment. And growing investments by Germany and Japan in the United States promise to accentuate our own position as the second largest host to foreign investment, after Canada.

If past experience concerning the international interplay of national economic policies has taught us anything, it should be that we need to identify and devise means to address problems at an early stage -- before vested interests become so strong that a crisis is required to bring forth appropriate international action. Failure to take early action in the area of trade, for example, led to trade wars and competitive exchange rate devaluations during the 1930's, actions which doubtlessly deepened and prolonged the Great Depression. Only after the Depression actually occurred were trade and monetary rules created that were designed to prevent its recurrence.

In the case of international investment, we are not yet to a point where vital interests have been sufficiently damaged as a result of undesirable national competition for international investment as to create a global crisis. Even so, individual problems, such as those mentioned above, have produced some clashes.

Developments to Date

It is therefore encouraging that progress is being made on several fronts to deal with the problems I have discussed. I noted earlier the 1976 OECD investment instruments. Additionally, the OECD is working on a Medium

Term Work Program on investment incentives and disincentives. The first stage of this program will consist of an analysis of the effects of such measures on the international investment process. We hope that this effort will result in greater consensus among OECD member countries on ways to deal with problems in this area.

I will in the meantime be chairing in June the first meeting of the Investment Task Force of the Development Committee, an intergovernmental group under the combined auspices of the International Monetary Fund and the World Bank. This task force is a newly created entity which will provide a forum for subministerial-level representatives of governments from a group of developing and industrialized nations to discuss investment problems, and to search for specific steps which might be taken to improve the contribution of direct investment to the development process.

The United States is currently engaged in talks with Canada over the use of investment incentives in the automobile industry. It is noteworthy that the Canadian Minister for Industry, Trade and Commerce, Mr. Horner, in March called for discussions with the U.S. "on an urgent basis ... to reach agreement to contain such investment incentives." We hope that these talks will ultimately result in agreement between our nation and our close neighbor to limit these incentives.

The Shape of International Cooperation

To predict the form that international cooperation in the investment area might ultimately take is difficult. No matter what forum deals with this matter, several intellectual and institutional problems would inevitably have to be faced. For example, we might ask:

-- When is an incentive legitimate as a means to offset the disadvantage of investing in a particular locale, and when does it exceed that bound?

-- When does an incentive actually induce a firm to shift production from one nation to another, as opposed to influencing where among several sites within a nation it might locate?

-- Can the investment issue be handled through the GATT and other instruments and institutions of trade policy, or does it call for separate or additional responses?

We do not pretend to have clear answers to these questions. Nonetheless, we believe that it is important to try to distinguish an acceptable incentive from an unacceptable one. Two principles can be tentatively put forth: an undesirable investment incentive would be one which would <u>both</u>

1) Cause industrial investment to be located in the territory of the nation granting the incentive, while in the absence of the incentive the investment would go to some other nation's territory.

2) Distort the efficient allocation of resources as between any pair of nations.

It should be noted that, under these principles, measures which are sometimes referred to as "incentives" but in fact amount to the removal of government imposed disincentives to investment would not be condemned. Such exempt measures, for example, would include broad-based tax reductions and the liberalization of government regulations which affect business. These measures would constitute a move by government toward a "neutral" role in investment decisions. If one government moves toward "neutrality," it should be above criticism by other governments. By contrast, direct or indirect subsidies to a firm which are not compensatory in nature -- including operating subsidies, subsidized loans, free provision or payment of front end cash or noncash grants to the firm -- would be covered.

We also believe that all incentives should be transparent and open to any potential investor. Thus, "tailor-made" incentives which are offered only to a single, specific investor or group of investors should be avoided, even if the incentives are not in violation of the principles just stated.

Two categories of incentives may require special treatment. One encompasses incentives designed to draw investment into disadvantaged or depressed regions of a nation. The other covers incentives to research and development. Arguments based on sound economic reasoning suggest that a limited case might be made for direct subsidies in each of these areas. While I will not review the arguments today, special treatment for depressed regions and for research and development may be necessary.

Dealing with performance requirements is as difficult as dealing with investment incentives. In general terms, it can be argued on economic grounds that any performance requirement is undesirable unless it acts to offset some imperfection in the working of the market.

The problem is to determine what, if any, imperfections exist in a given situation and to determine if performance requirements act solely to correct the deficiency. Such a determination is particularly thorny in the context of the so-called "North-South dialogue." Performance requirements are often justified as necessary to assure that multinational enterprises meet local goals of host governments. But abuses by multinational firms in developing nations, while they undoubtedly occur, are much exaggerated, and we believe that the case for performance requirements is overstated. It is true that performance requirements are primarily designed to further the social goals of developing nations, however, and we must therefore be willing to be flexible in dealing with them on these issues.

Whether or not we should seek to deal with these issues in the context of the existing institutional framework for trade, or in another new context, is an intriguing matter. The recent Multilateral Trade Negotiations (MTN) succeeded in establishing new international rules on government practices which affect the investment area. For example, agreement was reached on new international commitments to prevent or limit the effects on trade of export and domestic subsidy programs. Under the new MTN Subsidies/ Countervailing Measures Code, a signatory could take countermeasures if it determined that another nation's subsidy program had caused material injury to one of the signatory's industries because of subsidized exports. In addition, in the case of an outright export subsidy, any adverse effect on another nation's trading interests would be sufficient to justify countermeasures. Some of the incentives currently used to attract foreign investment would be covered under these provisions. Under the new agreement, those countries whose production and trade interests are harmed by other's subsidies, including investment incentives, will have recourse to an internationally sanctioned means of dealing with the situation.

One might well ask why the entire problem of investment incentives cannot be handled through these agreements rather than through arrangements related directly to investment policies. Part of the problem in doing so lies in the fact that such incentives, rather than creating trade, may destroy opportunities for trade by creating import substituting investment and thus be hard to reach via trade mechanisms.

More importantly, however, use of tools designed to deal with actual trade flows would frequently represent a case of "too little and too late" in responding to investment incentives. In 1973, for example, the United States could respond actively to Canadian investment incentives which lured a Michelin tire plant to Canadian soil only after imports of tires from the plant began to enter the

United States. Action was needed before the plant was built. Trade sanctions, such as countervailing duties, have traditionally been taken after production is underway and trade is established, long after millions of dollars are invested in a facility and jobs are transferred from one location to another. When that kind of damage has already been done, trade sanctions have been unable to remedy the injury. It is possible that the threat of a countervailing action by another country would have some deterrent effect on government subsidies, and we are now studying how much of the investment incentive problem can be met by the new GATT rules. But whatever the agreed mechanism, the important thing is to deal with competition between governments at all levels.

Conclusion

As I have indicated, the groundwork for further international cooperation is now being laid. At this point in the discussions, the outcome is uncertain.

Those of us who are convinced of the need for additional international action to deal with the problems arising from governmental intervention in the investment process face a difficult period of education and persuasion to overcome the skepticism of those who as yet remain unconvinced. We must also solve the tricky substantive questions involved in establishing criteria as to which incentives are acceptable and which are not. We will proceed, however, with the mistakes of the past fully in mind and in the conviction that these difficulties can and will be overcome.

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Statement of
Donald C. Lubick
Assistant Secretary of Treasury for Tax Policy
Before the
Committee on Ways and Means
May 14, 1979

Mr. Chairman and members of the Committee:

We welcome the opportunity to present the Administration's views on H.R. 3712. The bill would generally prohibit the use of tax exempt bonds for single-family housing.

We are pleased to give H.R. 3712 our full and undondititional support in all material respects. Over the past few months, we have become increasingly concerned that mortgage subsidy bonds are wasteful, expensive, and inflationary. By 1984, they could cost the taxpayers of this country as much as $10 or $11 billion a year. Most of this money would be wasted; very little would go to those families who actually need public assistance. At the same time, these billions of dollars would add to inflation in the price of housing and other goods and services. We believe that Mr. Ullman, Mr. Conable, and the other distinguished sponsors of H.R. 3712 have addressed these concerns in a sound and responsible manner.

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Background

In the past few years, there has been an explosive increase in the volume of tax exempt revenue bonds issued by State and local governments for the purpose of making low interest mortgage loans for single-family homes. The Congress, the press, and the public have become increasingly concerned about these bonds. Their use has been condemned in publications of such diverse editorial opinion as The Washington Post, The Wall Street Journal, and The New York Times.

Because interest on these bonds is tax exempt, the bond proceeds can be used to make mortgage loans at approximately 2 percentage points below conventional mortgage rates. The security for the bonds is a pool of mortgage loans made with the bond proceeds, and the bonds are serviced by principal and interest payments collected from the individual mortgagors. The bonds are not backed by the credit of the issuer.

These mortgage subsidy bonds are part of a growing trend of using tax exempt bonds for private purposes. Traditionally, tax exempt bonds have been used almost exclusively for essential public projects such as roads, schools and municipal buildings. They have not been used for such private purposes as single-family housing.

A few State housing agencies began to issue small amounts of tax exempt bonds for single family housing in the early and middle 1970's. Most other State agencies adopted the practice in 1977 and 1978. However, the full extent of the potential volume of these mortgage subsidy bonds was not revealed until July of 1978. At that time, a major municipality sold a $100 million issue for homebuyers having annual family incomes of $40,000 or less. This was the first instance in which an issuer other than a State housing finance agency sold revenue bonds to make mortgage loans for single family housing.

Other localities soon concluded that they too could sponsor revenue bond programs at little or no cost to themselves. Experienced investment bankers have prepackaged plans that they can modify to fit the specifications of nearly any locality. Local savings and loans handle the administrative chores of processing loan applications, selecting those that are credit worthy and collecting monthly mortgage payments. Private insurance companies (or the FHA or the VA) provide layers of security for the bondholders.

Finally, the locality itself is not responsible in the event of default. The locality does not back the bonds in any way; security for bondholders is provided solely by the mortgages and mortgage insurance, and by reserve funds set up from bond proceeds at the time of issuance. Because localities have no responsibility and take no risk, they have every incentive to issue as many mortgage subsidy bonds as the market will bear.

To say mortgage subsidy bonds are spreading like wildfire is an understatement. During 1978, $622 million of these mortgage subsidy bonds were sold by localities, and the potential volume in 1979 is at least $3.8 billion. This explosive growth has occurred even though only about a dozen States currently have laws permitting localities to issue revenue bonds for this purpose. We expect that the vast majority of States will enact legislation authorizing issuance of these bonds in the next few years. Even now, enabling legislation has been introduced in many States.

The potential growth of mortgage subsidy bonds is enormous. In 1978 approximately $176 billion of gross new mortgage loans were made for single family housing. The total of all mortgage subsidy bonds in 1978 amounted to less than 3 percent of this volume. By way of comparison, the total volume for 1978 of all municipal bond issues was approximately $46 billion.

In 1968, Congress attempted to restrict the use of tax exempt bonds to traditional public projects. These include low income rental housing, but not single-family homes. Low-income projects afford the basic necessity of shelter to poor families. Single-family homes, by contrast, not only furnish shelter but perhaps also represent the best investment that most American families can make.

It is true that the present statute contains language ("residential real property for family units") broad enough to permit tax exempt bonds for single family housing. However, this was apparently an oversight. The statutory language was written in 1968, at a time when housing bonds were for multi-family projects; revenue bonds for single family housing were virtually unknown until the middle 1970's.

Cost

There surely is no way to get something for nothing. If certain homebuyers save money because of tax exempt bonds, these savings have to come from somewhere. And indeed they do -- the taxpayers pick up the tab.

The total cost of mortgage subsidy bonds depends directly on the volume of these bonds that are sold. Therefore, our estimates of revenue loss are based on a range of reasonable assumptions about the volume of bonds. If we assume that the volume of bonds will be sufficient to finance 10% of home mortgages, the cost will be $470 million in 1981. On the other hand, if the volume is sufficient to finance 50% of home mortgages, we stand to lose $1.6 billion in 1981 and $11.0 billion in 1984. In the longer run, we stand to lose as much as $22.1 billion a year (expressed in 1984 dollars).

A study recently prepared for Congressman Reuss and the Banking Committee by the Congressional Budget Office estimated that mortgage subsidy bonds would finance about 8% of all mortgages in 1984. In the short time that has elapsed since the CBO study was released, it has become clear that this estimate was far too conservative.

There quite literally are no natural limits on the potential growth of mortgage subsidy bonds. Put simply, no one wants 10% mortgage money when 8% money is available. Thus, it is not unreasonable to expect that close to 40% or 50% of all home mortgages could eventually be financed with tax exempt bonds.

Inflation

Mortgage subsidy bonds are highly inflationary for three reasons. First, their cost adds considerably to the budget deficit. The American people will perceive that we do not take inflation seriously if we choose, in effect, to spend billions of dollars annually on a new program of housing subsidies for the middle class.

Second, mortgage subsidy bonds have a direct and immediate impact on housing prices. By adding demand to a housing market that has been overheated, these bonds could have a substantial impact on the price of a home.

Third, mortgage subsidy bonds tend to frustrate monetary policies designed to help bring inflation under control by gradually cooling off the economy. Historically, the housing market has been especially sensitive to high interest rates. Consequently, when interest rates rose during previous business cycles, demand for housing fell off and this helped to stabilize the economy. During the most recent business cycle, however, the housing market has been largely insulated from the effect of higher interest rates. At first, money market certificates issued by savings and loan associations attracted a significant amount of additional capital to the housing market. More recently, we have attempted to correct the situation by reducing interest rates on these money market certificates. However, mortgage subsidy bonds threaten to defeat our efforts to have the housing market contribute its share to cooling off the economy. They insulate housing from high interest rates even more effectively than money market certificates; not only do the bonds attract capital, but they do so at below market rates.

Waste

Mortgage subsidy bonds are both wasteful and inefficient. The case for mortgage subsidy bonds is based on two premises: first, that middle class Americans need public assistance to buy homes, and second, that tax exempt bonds are the best way to provide that assistance. We believe that both of these premises are incorrect.

The first premise seems to assume that the majority of Americans need public assistance. This assumption turns the world upside down. It seems elementary that public assistance must be limited to those who could not otherwise afford basic necessities. Public assistance for housing must be limited to those families who need help if they are to have a safe and decent place to live.

Fortunately, middle class Americans do not need public assistance to buy homes. Even at the lower end of the middle class, most Americans are able to afford their own homes. For example, our most recent statistics show that nearly 2/3 of all families with incomes of between $10,000 and $15,000 own their own homes.

If mortgage subsidy bonds ever make any sense at all -- and we don't believe that they do -- it can only be when they are used for families who have no other way to get a mortgage. However, most of these families are necessarily excluded from mortgage subsidy bond programs. In order to attract investors and to obtain necessary insurance, mortgage subsidy bonds can be used only for families who meet conventional credit standards. In other words, if a family qualifies for a mortgage loan at a local bank or savings and loan association, then they can qualify for assistance under a mortgage subsidy bond program. However, if the family is not able to qualify for a conventional mortgage loan, then they are almost certain to be shut out of the subsidy program. Thus, families who do not have access to conventional sources of credit are unlikely to benefit from these bonds.

Moreover, mortgage subsidy bonds cannot possibly benefit families in the lowest income groups because these families simply are not able to afford their own homes. Consequently, mortgage subsidy bonds do nothing for those most in need of housing assistance.

The second premise is also incorrect. All tax exempt bonds are inefficient in the sense that the average cost to the taxpayers exceeds the savings to the issuer of the bonds. This inefficiency is compounded in the case of mortgage subsidy bonds because a significant portion of the bond proceeds are not used to make mortgage loans, but instead are wasted on lawyer's fees, underwriter's fees, reserve funds, and other similar items. In addition, substantial administrative fees must be paid each year. The net result can be that of each $1.00 of cost to the taxpayers, significantly less than 50¢ or 60¢ is actually passed on to homebuyers.

Additional policy considerations

Over a period of years, mortgage subsidy bonds could result in substantial changes in the basic structure of our economy and tax system. We would like to address a few of the most important of these changes.

First, there would be a sizable shift in the allocation of capital between housing and other sectors of the economy. In particular, large amounts of capital would flow into the housing sector at the expense of industrial plant and equipment. This could only serve to aggravate the problems we have had over the past 5 or 10 years in promoting capital formation.

In this regard, it should be noted that existing Federal policies do much to attract capital into the housing market. For example, tax expenditures for single family housing (i.e., deductions for mortgage interest and property taxes and special capital gains rules) will alone amount to more than $16 billion in fiscal year 1980. This is in addition to extensive programs for mortgage insurance. It is doubtful that we should do very much more to encourage capital investment in housing at the expense of industrial plant and equipment.

Mortgage subsidy bonds also have a direct effect on the stock market. To a fair extent, stocks and tax exempt bonds compete with each other for the same funds. Many wealthy investors who can afford to take risks in the stock market are attracted instead to tax exempt bonds. Mortgage subsidy bonds could easily result in a doubling of the supply of tax exempt bonds that comes to market. If they do, this could frustrate many new and growing corporations in their attempts to raise venture capital.

Second, there could be a substantial effect on the market for tax exempt bonds. In the first quarter of this year, mortgage subsidy bonds accounted for nearly 30% of all new issues. This additional supply had a considerable impact in driving up interest rates on tax exempt bonds, but H.R. 3712 has already brought these rates down. Compared to interest rates generally, tax exempt rates have become very low by historic standards as a result of the introduction of H.R. 3712.

More precisely, it has been estimated that tax exempt rates increase by between 4 and 7 basis points for each billion dollars of mortgage subsidy bonds sold. As tax exempt rates increase, it becomes progressively more expensive for State and local governments to finance essential public projects such as schools, roads, and other public works. Some localities, especially those with a weaker credit, may be denied access to the market altogether. It has been estimated that each billion dollars of mortgage subsidy bonds drives perhaps $100 million of conventional municipal bonds off the market.

The impact on other tax exempt housing bonds will be especially severe. It has been estimated that each billion dollars of mortgage subsidy bonds will result in an increase of between 11 and 14 basis points in the cost of tax exempt financing for low and moderate income rental projects. Thus, mortgage subsidy bonds will actually increase the cost of shelter for those most in need.

In addition, if mortgage subsidy bonds are part of a trend -- and they would appear to be -- radical changes could be ahead for the tax exempt market. This market has been increasingly diverted from its historic use for traditional public projects. For example, revenue bonds now comprise about 2/3 of the tax exempt market, while general obligation bonds were predominant as recently as two or three years ago. As the tax exempt market expands, there will be a considerable change in the method of allocating capital within our economy. Decisions about the allocation of capital will be made increasingly by government, and not by market forces.

This Administration has consistently recognized the need for a strong and active tax exempt market so that State and local governments can effectively carry their share of responsibilities under our federal system. However, as the tax exempt market swallows up an increasingly large share of the sources of capital, its purpose is diluted and its effectiveness is diminished.

Third, mortgage subsidy bonds raise substantial questions about the role of government in our free enterprise system. In many localities across the country, government has gone into business in direct competition with local banks and savings and loan associations. As a major newspaper has noted, this development "carried to its logical, which is to say political conclusion, . . . would put local governments in full competition with private enterprise -- the banks and savings and loans. Those institutions could not win in such a competition because of the income-tax quirk and might well be replaced eventually by local governments as the source of almost all mortgage money." (The Washington Post, April 21, 1979, page 14.) We do not believe that it would be healthy to have government replace free enterprise in such a large sector of our economy.

Fourth, a large increase in the volume of tax exempt bonds would do considerable injury to the fairness of our tax system. It would literally make it possible for wealthy investors to escape taxes completely on billions of dollars of income each year. We should not be making it any easier for the rich to avoid paying taxes.

Other provisions

H.R. 3712 would continue to allow tax exempt financing for rental housing, but would limit such financing to low and moderate income projects. In some instances, tax exempt financing has been used in connection with high rent projects for the well-to-do. Therefore, we believe a limit of this kind is necessary and appropriate. However, we are concerned that the bill may go too far in limiting efforts to promote economically integrated rental housing for low and moderate income families.

The bill also would allow States to finance homes for veterans with tax exempt general obligation bonds. We believe that the Committee should eliminate this provision.

For the next several days, the Committee will be hearing testimony from a number of witnesses who have sincere concerns about various provisions of H.R. 3712. We understand that members of the Committee may want to accomodate certain of these concerns. For example, as noted above, some economically integrated rental projects may inadvertently have been affected. In addition, there is some concern regarding transitional rules for financings that were very far along on April 24. We would be glad to work with the Committee and its staff in developing such changes as may be necessary.

Conclusion

In concluding, we would like to return to the three points that we made at the beginning of our testimony. First, mortgage subsidy bonds are enormously expensive and could eventually cost as much as $10 or $20 billion a year. Second, they make it harder to solve this nation's number one economic problem, which is inflation. And third, they waste an enormous amount of money on public assistance for the well-to-do. For these reasons, we are opposed to mortgage subsidy bonds, and are in full agreement with Mr. Ullman, Mr. Conable, and the carefully thought out legislation that they have introduced.

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Appendix A

Calendar Year Change in Tax Liability
Under H.R. 3712

Projected Market Share in 1984 of Single-Family Mortgages Financed With Tax-Exempt Bonds	(...........$ in Millions					................)
	1979	1980	1981	1982	1983	1984
0.10	39	183	469	920	1,549	2,345
0.20	50	260	771	1,643	2,878	4,492
0.30	56	325	1,057	2,368	4,236	6,681
0.40	63	382	1,331	3,082	5,586	8,868
0.50	68	434	1,598	3,791	6,931	11,049

Office of the Secretary of the Treasury
Office of Tax Analysis

May 14, 1979

Appendix B

Long-Run Reduction in Tax Liability From
Tax Exemption of Mortgage Subsidy Bonds
(Excluding Veterans' Programs)
1984 Levels

($ in Millions)

Market Share of Single-Family Mortgages Financed With Tax-Exempt Bonds Under Current Law	Revenue Cost: Current Law
0.10	4,413
0.20	8,826
0.30	13,239
0.40	17,652
0.50	22,064

Office of the Secretary of the Treasury
Office of Tax Analysis

May 14, 1979

These figures reflect volumes of mortgages outstanding financed with tax-exempt housing bonds at alternative projected long-run shares of mortgage market. The projected end of 1984 stock of all outstanding mortgages for single-family housing is $1,678.3 billion.

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May 9, 1979

DEPARTMENT OF THE TREASURY
OFFICE OF THE SECRETARY
SALARIES AND EXPENSES

Introductory Statement of W. J. McDonald
Acting Assistant Secretary (Administration)
For Presentation to the Subcommittee on Appropriations

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to come before you today to present the 1980 request for the Office of the Secretary "Salaries and Expenses" appropriation. The Office of the Secretary is requesting $30.9 million and 831 permanent positions for 1980, which is a decrease of $.2 million from the authorized level proposed for 1979. In addition, $979,000 is requested to cover the Office of the Secretary civilian pay act requirements for 1979.

The Office of the Secretary appropriation request includes positions and funds to support the Secretary and his staff of policy officials--which include officials and their staffs engaged in tax policy formulation, economic policy matters, legislative affairs, debt management, and legal matters. Likewise, it includes the administrative support activities which are an inherent part of the Office of the Secretary.

This request, in keeping with the President's battle against inflation, is lean and austere. The budget requests

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an increase of 10 permanent positions and $560,000, plus $858,000 in resources to maintain the current level of operations. These requested increases, however, are offset by a reduction of 18 permanent positions and $1,596,000. Thus, when compared with the level authorized for FY 1979, it represents a net decrease of eight permanent positions and $178,000.

Included in the program increases is a request for three additional positions for the Assistant Secretary (Domestic Finance). These positions are requested specifically to provide added analytical capability to the Office of Government Financing. This office provides the Secretary and others with technical assistance and financial and economic data on matters related to government financing, public debt management, federal credit programs, and related economic and financial problems. Specifically, the need for research and analysis of the Treasury securities market has increased in view of the large and continuing demands in the market as the result of budget deficits and substantial refunding burdens. Such research and analysis should lead to the development of more efficient financing techniques and result in substantial savings in interest costs.

Three positions are requested to carry out the respon-sibilities of the Assistant Secretary (Tax Policy). These positions are needed to process the large amounts of data required for sound policy decision in the following areas: resolving fiscal and energy-related problems through the tax system; the budget deficit; tax expenditure estimates; the tax treatment of capital gains to stimulate investment and economic growth; highway excise tax structures; and Social Security and welfare reform.

I am requesting two additional positions for the Assistant Secretary (Legislative Affairs). This staff is quite small and unable to respond adequately to requests for advice, counsel, and other legislative activities by Treasury officials. The increased activity in areas of trade, tariff and anti-inflation legislation necessitates close liaison with the Congress, White House, and other executive departments to keep abreast of priorities, activities, and attitudes, and also to see that all parties are provided with the proper information on which to base their decisions.

Two positions are requested to aid the General Counsel in carrying out the statutory responsibilities assigned to the Secretary for oversight of the U.S. rail transportation system, including Conrail and the U.S. Railway Association. Increasing demands in this area preclude the continuing diversion of resources from other activities to work on rail and transportation matters.

The Office of the Secretary computer center requires $300,000 in 1980 to convert to a new leased computer system and to affect improvements to the present computer site. Approximately one-half of this amount will be required to provide programming assistance, rental costs supporting parallel operations and additional communication lines during conversion. The remainder will be required to make space alterations, provide new air conditioning units and make electrical and fire renovations to the existing site.

Changes to the budget, other than the program increases already mentioned, include an increase of $858,000 to maintain the current level of operations. These funds provide for increasing communication costs, within-grade salary increases, space costs, the annualization of increased positions granted in 1979, and similar costs for the ongoing current programs.

The budget increases are offset by a decrease of 18 permanent positions and $1,596,000 for program reductions, primarily the items authorized for the repairs and improvements in 1979. The reduction includes 13 administrative positions and 5 buildings maintenance positions.

Pursuant to Executive Order 12087, this committee also has before it a supplemental request of $979,000 to cover the Office of the Secretary civilian pay act requirements.

This concludes my prepared statement, Mr. Chairman. I shall be happy to answer any questions you or other members of your Committee may have.

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

FOR IMMEDIATE RELEASE May 14, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,000 million of 13-week Treasury bills and for $3,001 million of 26-week Treasury bills, both series to be issued on May 17, 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 August 16, 1979			26-week bills maturing November 15, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.606	9.471%	9.86%	95.233	9.429%	10.07%
Low	97.589	9.538%	9.94%	95.209	9.477%	10.12%
Average	97.597	9.506%	9.90%	95.218	9.459%	10.10%

Tenders at the low price for the 13-week bills were allotted 4%.
Tenders at the low price for the 26-week bills were allotted 76%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 43,610,000	$ 43,610,000	$ 61,145,000	$ 44,225,000
New York	4,117,975,000	2,363,975,000	4,595,870,000	2,452,470,000
Philadelphia	24,350,000	24,350,000	12,165,000	12,165,000
Cleveland	50,675,000	50,675,000	30,520,000	29,800,000
Richmond	22,615,000	22,615,000	23,585,000	23,585,000
Atlanta	37,910,000	37,910,000	32,525,000	32,515,000
Chicago	311,865,000	168,665,000	242,770,000	132,290,000
St. Louis	46,290,000	27,290,000	36,960,000	15,480,000
Minneapolis	18,905,000	9,105,000	20,055,000	8,855,000
Kansas City	49,245,000	49,245,000	37,615,000	37,615,000
Dallas	19,575,000	19,575,000	11,085,000	11,085,000
San Francisco	220,365,000	168,445,000	226,880,000	174,240,000
Treasury	14,820,000	14,820,000	26,310,000	26,310,000
TOTALS	$4,978,200,000	$3,000,280,000a/	$5,357,485,000	$3,000,635,000b/

a/Includes $515,175,000 noncompetitive tenders from the public.
b/Includes $367,315,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

B-1597

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

IMMEDIATE RELEASE
May 14, 1979

Contact: Charles Arnold
566-2041

STATEMENT BY DEPARTMENT OF THE TREASURY

The U.S. Executive Director of the International Monetary Fund (IMF) did not dissent from today's decision of the IMF to approve requests from the Government of Nicaragua for balance-of-payments financing totalling SDR 51.6 million, equal to about U.S. $66 million.

The U.S. position on these requests was based solely on economic and financial criteria, in accordance with the long standing U.S. policy that decisions in the IMF should be based only on economic and financial considerations and uniformity of treatment for all members.

The requests consisted of three parts:

1. A request for a stand-by arrangement providing for drawings up to SDR 34 million (approximately U.S. $43 million) between now and the end of 1980 under Nicaragua's four credit tranches. Any IMF member can qualify for such credit tranche drawings provided it has a balance-of-payments need and presents to the Fund a stabilization program giving substantial justification of the member's efforts to overcome its balance-of-payments difficulties.

2. A request for a drawing of SDR 17 million (approximately U.S. $22 million) under the Compensatory Financing Facility. A member having a balance-of-payments need may draw under this Facility if experiencing temporary shortfalls in its export earnings due to circumstances largely beyond the member's control, and if the member cooperates with the Fund in an effort to solve its balance-of-payments problems.

3. A request of SDR 583,000 (approximately U.S. $740,000) under the IMF Buffer Stock Facility. Members with balance-of-payments difficulties are entitled to draw under this Facility to help finance contributions to international commodity buffer stocks which have been approved by the IMF -- in this case covering sugar. (Such buffer stock arrangements are aimed at stabilizing the prices of primary products).

It was the judgment of the IMF Management and staff that the request from Nicaragua met the technical criteria for drawings under each Facility indicated above. The U.S. Government, after careful review, concurred in this judgment. There was therefore no economic basis on which to dissent from the IMF decision.

This position should not be construed as a political action, or as directly or indirectly reflecting any change in the United States concerns over events in Nicaragua. The Department of State is today issuing a press statement on this matter.

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B-1598

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

FOR IMMEDIATE RELEASE
Friday, May 11, 1979

Contact: Charles Arnold
202/566-2041

STATEMENT BY THE HONORABLE ANTHONY M. SOLOMON
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
ON U.S.-CHINA CLAIMS/ASSETS AGREEMENT

The U.S.-China claims/assets agreement was formally signed in Beijing on May 11 at 9:00 a.m. local time by Commerce Secretary Kreps and Finance Minister Zhang Jingfu. This continues the momentum begun during Secretary Blumenthal's February 24 -March 4 visit when he negotiated and initialed the agreement.

"We hope that this momentum will carry us through the successful conclusion of bilateral trade and textile agreements this month," said Undersecretary for Monetary Affairs Anthony Solomon who accompanied Secretary Blumenthal to Beijing. "The formal completion of the claims/assets settlement marks the first crucial step forward in the normalization of our economic relations -- a process that, I am confident, can be rapidly completed with this issue now behind us."

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B-1599

Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

IMMEDIATE RELEASE
May 14, 1979

CONTACT: Charles Arnold
202-566-2041

TREASURY ANNOUNCES NEW RULES ON SECURITY AUCTIONS

The Treasury Department announced today that it is implementing two new rules concerning its offerings of marketable securities. Decisions on these new rules were reached in conjunction with the joint Treasury/Federal Reserve Board study of futures contracts based on Treasury securities.

First, effective immediately, the maximum award to any single bidder in Treasury security offerings will be limited to 25 percent of the total of the combined amounts of the competitive and the noncompetitive awards to the public. This modified a previous rule which allowed a single bidder in a Treasury auction to receive as much as 25 percent of the announced amount of the public offering. The new rule excludes from the 25 percent calculation those Treasury securities allotted to the Federal Reserve in exchange for maturing securities held both for its own account and for the accounts of foreign official institutions. It also excludes Treasury securities allotted to the Federal Reserve for new cash tenders on behalf of foreign official institutions.

This new 25 percent rule is needed because the proportion of Treasury bill offerings accounted for by the competitive plus noncompetitive award to the public has declined significantly in recent years. The Treasury Department expects this change to eventually broaden the competitiveness of the auction process and contribute to improved distribution of new securities.

Second, beginning June 18, 1979, the Treasury will require all bidders in its bill auctions to report on the tender form the amount of any net long position in excess of $200 million in the bills being offered. This information should reflect positions held at the close of business on the day prior to the auction. Such positions would include bills acquired through "when-issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g. bills with three months to maturity previously offered as six-month bills. Also, a primary dealer bidding on behalf of a customer will be required to submit a separate tender for the customer whenever the customer's net long position in the bill being offered exceeds $200 million at the close of business on the day prior to the auction.

This information will be taken into consideration by the Treasury when awarding new bills. The Department's objective is to reduce the potential for undue concentration of ownership in new issues and to contribute to improved distribution. This new reporting requirement recognizes the rapid expansion of trading in Treasury bill futures as well as "when-issued" trading occurring between the offering announcement and the auction date.

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

FOR RELEASE AT 4:00 P.M. May 15, 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 May 24, 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 $ 5,911 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 February 22, 1979, and to mature August 23, 1979 (CUSIP No. 912793 2H 8), originally issued in the amount of $3,015 million, the additional and original bills to be freely interchangeable.

183-day bills for approximately $2,900 million to be dated May 24, 1979 and to mature November 23, 1979 (CUSIP No. 912793 2W 5).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing May 24, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,479 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 Daylight Savings time Monday, May 21, 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-1602

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 May 24, 1979, in cash or other immediately available funds or in Treasury bills maturin May 24, 1979. Cash adjustments will be made for differenc 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
May 15, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY ANNOUNCES FINAL DETERMINATION
IN COUNTERVAILING DUTY INVESTIGATION ON
VISCOSE RAYON STAPLE FIBER FROM SWEDEN

The Treasury Department today announced a final determination that Sweden is subsidizing exports of viscose rayon staple fiber to the United States.

The Countervailing Duty Law requires the Secretary of the Treasury to collect an additional duty equal to the subsidy paid on merchandise exported to the United States.

As a result of its investigation, Treasury found that the manufacturer of this merchandise received subsidies consisting of payments made to encourage the continued employment of older workers, and interest-free loans.

Since payments received under the older workers program are currently offset by the extra expenses borne by the sole Swedish producer of the product investigated, Svenska Rayon AB, the rate of countervailing duty that applies is zero.

The interest-free loans to Svenska are provided for the acquisition of machinery and equipment for the production of "modal" fiber, which is superior to the prevalent form of fiber, known as regular fiber. The subsidy payments limited to the production of modal fiber are not considered to be a benefit for the production of regular fiber.

The amount of the subsidy has been determined to be 8.6 percent of the f.o.b. value of modal fiber exported to the United States.

The grant of funds under a third program devised to stockpile raw materials and maintain extra production capacity for national economic defense purposes was determined not to constitute a subsidy. This determination is the result of strict management control that prevents the use of stockpiled fiber or mothballed machinery for commercial purposes.

Notice of this action appears in the Federal Register of May 15, 1979.

Imports of this merchandise from Sweden during 1977 were valued at about $2.1 million.

B-1603

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

IMMEDIATE RELEASE
May 14, 1979

Contact: Charles Arnold
(202) 566-2041

TREASURY AND FEDERAL RESERVE MAKE
JOINT RECOMMENDATIONS ON FUTURES CONTRACTS
ON TREASURY SECURITIES

The Treasury Department and the Federal Reserve Board today released joint recommendations to the Commodity Futures Trading Commission (CFTC) on futures trading in Treasury securities.

The recommendations result from a study by the Treasury and Federal Reserve. The study was initiated after Treasury Secretary W. Michael Blumenthal and Federal Reserve Chairman G. William Miller, in October 1978 letters to the CFTC, expressed concerns over the possible consequences of further rapid expansion in trading of Treasury futures contracts.

In their October letters, Secretary Blumenthal and Chairman Miller suggested a moratorium on new authorizations of Treasury futures contracts until a Treasury/Federal Reserve study could be completed.

A report summarizing the study's findings and the joint recommendations is attached. It was sent today to the CTFC.

The Treasury and Federal Reserve recommend that:

1. Adequacy of Deliverable Supply

-- The CTFC should consider not just the width of the maturity range defining issues eligible for delivery, but also the number of already outstanding issues that will move into that range as the contract approaches delivery, the size of those issues, and their likely availability in the secondary market (as suggested by the length of time they have been outstanding and their distribution by type of holder). These questions should be addressed explicitly in the analysis prepared for the Commission by its staff when new contract designations are being considered. Studies of how the prices of given issues vary relative to those of adjacent issues will help to shed light on this question of availability.

-- In no case should the CFTC approve a contract that depends for its deliverable supply solely on a particular security yet to be issued.

-- Where contracts specify a relatively narrow maturity range for the deliverable supply, approval should also be withheld on new contracts if the deliverable supply of already outstanding maturities consists of only small amounts of closely-held issues.

-- To assure that the exchanges regularly review the terms of all outstanding contracts in relation to changes in the structure of marketable Federal debt, the CFTC should reestablish a "sunset" provision for new contracts requiring them to be reviewed and reauthorized every few years.

2. Existing 1-year Bill Contract

-- Because its deliverable supply depends wholly on a single new security not yet issued, the existing 1-year bill contract should be modified to assure a broader deliverable supply or, in the alternative, withdrawn.

3. Existing 3-month Bill Contract

-- Because the 3-month bill contract has become so well established and so actively used in its present form, a redefinition of deliverable supply at this juncture seems unwarranted.

-- However, in view of the concerns expressed by market participants that the 3-month contract has been vulnerable to squeezes under certain conditions, steps should be taken to minimize these possibilities through improved data collection and monitoring of interactions between the futures and cash markets.

4. Potential Risks of Contract Proliferation

-- The CFTC should proceed gradually in authorizing additional contracts for financial futures. In the untested intermediate-term sector, for example, a first step might be to authorize only one note contract, on one exchange, with a range of eligible maturities sufficient to provide a reasonable "market basket" of delivarable supply. Further, the CFTC should not designate contract markets on more than one exchange for essentially identical contracts unless it has entered into formal agreements with each exchange to provide uniform reporting of contract positions to the CFTC and to establish uniform emergency procedures that would be implemented jointly and coincidently at the request of the CFTC.

5. Safeguards for Investors

-- Further study of investor protection and exchange regulation being conducted jointly by the CFTC, the Treasury, and the Securities and Exchange Commission should proceed. Among the issues to be explored should be appropriate customer suitability standards, margin requirements, and positions limits.

-- In addition, the CFTC and the exchanges promoting futures contracts should make clear securities are not obligations of the U.S. Treasury. To avoid any confusion on this question, the exchanges should not use pictures of the Treasury building or of Treasury securities in their promotional material.

The full study will be released later.

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THE SECRETARY OF THE TREASURY
WASHINGTON 20220

May 14, 1979

Dear Commissioner Stone:

In our separate letters dated October 19 and 25, 1978, we expressed concerns over the possible consequences of further rapid expansion in trading of Treasury futures contracts and requested a moratorium on new authorizations of such contracts until our staffs could conduct a thorough study of the markets for Treasury futures. That joint study has now been completed. The Treasury/Federal Reserve recommendations stemming from it are enclosed for your consideration, together with a summary of the study. The full study itself will be separately provided to you.

We appreciate the assistance which you gave us in this effort and your understanding of the important public interest issues involved in futures markets based on U. S. Government securities. We look forward to working with you to assure the appropriate development of these markets.

Sincerely,

W. H. Blumenthal

W. Michael Blumenthal
Secretary of the Treasury

G. William Miller

G. William Miller
Chairman
Board of Governors of the
Federal Reserve System

The Honorable
James M. Stone
Chairman
Commodity Futures Trading
Commission
2033 K Street, N. W.
Washington, D. C. 20581

Enclosure

TREASURY/FEDERAL RESERVE STUDY OF TREASURY FUTURES MARKETS

Summary and Recommendations

May, 1979

Introduction

The rapid growth in recent years of futures trading in U.S. Government securities raises a number of questions of importance to the Treasury and to the Federal Reserve:

> Does futures trading in U.S. Government securities affect adversely the efficiency and integrity of the underlying cash market for those securities?
>
> Is the trading of futures contracts which depend on deliverable supplies of Government securities likely to constrain the Treasury in its debt management decisions?
>
> Will the exchanges and the Commodity Futures Trading Commission (CFTC) be capable of maintaining effective surveillance of financial futures markets, particularly as essentially duplicative contracts trade simultaneously on several exchanges?
>
> Is there a danger that unsophisticated investors will not fully appreciate the risks inherent in futures contracts whose names suggest the backing of the U.S. Treasury?

The September 30, 1978, legislation (P.L. 95-405), which renewed the authority of the CFTC to regulate futures markets, directs the Commission to solicit the advice of the Treasury and the Federal Reserve before authorizing any additional futures contracts that specify delivery of U.S. Government securities. The Act also requires the Commission to consider the impact of such futures trading on the debt management requirements of the Treasury and on the efficiency and integrity of the market for U.S. Government securities. Confronted with the need to comment on several pending contract proposals, yet lacking a body of research on which opinions could be firmly grounded, the Secretary of the Treasury and the Chairman of the Board of Governors wrote the CFTC in October, 1978, suggesting an immediate Treasury-FRB study and requesting a moratorium on new authorizations of Treasury futures contracts until the study could be completed.

Since then the staffs of the Treasury and the Federal Reserve have conducted over thirty interviews with a wide variety of participants in both the cash and futures markets for Government securities. The findings from these interviews, from current staff studies, and from previous studies of futures markets are summarized below under three broad headings.

1. The potential benefits from these markets;
2. The potential problems which they might pose for the efficient operation of the underlying market in U.S. Government securities, for the Treasury in its debt management, and for particular categories of investors; and
3. Conclusions and recommendations.

The discussion of the findings is preceded by a brief introduction to the institutional background of financial futures. A much more complete discussion of the potential strengths and problems of futures markets is contained in a separate staff study, which also includes a summary of the interviews with market participants and a more extensive treatment of the regulatory structure of the industry.

The Institutional Background

1. The Product

A futures contract is an agreement to buy or sell a particular good--traditionally, an agricultural commodity--on some specified *future* date, but at a price determined *now* by competitive bidding on the floor of an exchange. Since late 1975, futures contracts on a number of financial instruments have been introduced, including ones based on 3-month and 1-year Treasury bills, which trade on the International Monetary Market (IMM) of the Chicago Mercantile Exchange (CME), and one based on long-term Treasury bonds, which is listed on the Chicago Board of Trade (CBOT). Applications by these and other exchanges for additional contracts on Treasury securities are now pending before the CFTC. Some of them are essentially duplicative of the bill and bond contracts, but others propose futures contracts on Treasury notes ranging in maturities from two to seven years.

Trading volume in the 3-month bill and bond contracts has grown rapidly, averaging over 4,000 contracts a day for each. (A single bill contract is for $1 million face value of bills; each bond contract, for $100,000 par value of bonds.) The number of contracts outstanding (the "open interest") recently has been roughly 55,000 in the case of the 3-month bills and 45,000 for the bonds. Interviews with market participants indicate that this trading activity has been largely speculative, although there is evidence of hedging by investors seeking protection against the risk of interest rate changes. (The difficulty in distinguishing hedging from speculating is discussed below).

Despite the heavy trading volume, typically only a relatively small number of contracts culminate in actual delivery on each maturity date, the remainder having been liquidated by offsetting trades. This pattern of few deliveries is common to all organized futures markets, i.e., markets on which <u>standardized</u> contracts for future delivery are traded on regulated <u>exchanges</u>, which require all positions to be "marked to market" daily. By contrast, deliveries are the rule rather than the exception for <u>forward</u> contracts, which are unregulated agreements between two parties to exchange a good or security at an agreed-upon price on some specified future date, and which can be tailored to meet individual needs.

2. <u>Exchanges</u>

Exchanges are nonprofit associations whose membership is generally composed of individuals. The privileges of exchange membership include the right to trade on the floor for one's own account, the right to collect a brokerage fee for executing trades for others, and the right to vote for the members of the governing body of the exchange. The governing ody--composed of both members and nonmembers--is ultimately responsible for enacting and enforcing the rules of the exchange and, thus, for much of the self-regulation of the futures industry.

Each exchange maintains a clearinghouse which acts as a third party to every trade. That is, the clearinghouse is directly or indirectly the other party in every futures contract: the buyer to every seller, and vice versa. In this sense, the exchange stands behind every contract.

Exchange members acquiring contracts for their own account or for their customers must deposit assets with the exchange equal to a certain proportion of their contractual obligations. Such deposits, which can take several forms including cash, Treasury securities or, in some cases, a letter of credit, are commonly referred to as margins. They are, however, really in the nature of a bond that guarantees eventual performance of contract terms rather than a down-payment that limits the use of credit to purchase a security. The exchanges have exclusive authority to set margin levels.

The equity value of the exchange member's margin account will, of course, vary with the market price of contracts. At the end of each trading day the clearinghouse "marks to market" each account--i.e., the effects of the day's price movement are calculated. If a loss is incurred which depletes the margin account, the exchange member is notified and he must send a certified check before the start of business the following morning to restore the account to its required level.

The exchanges also require their members to obtain margins from their customers. These accounts are also marked to market, but the procedures members use for their customers on margining and marking to market do not have to be uniform.

3. The CFTC

The Commodity Futures Trading Commission, established in 1975, is composed of a Chairman and four other Commissioners appointed by the President and confirmed by the Senate to serve staggered five-year terms. The CFTC has broad regulatory authority over futures trading, and it must approve all futures contracts traded on U.S. exchanges, ensure that the exchanges enforce their own rules (which it must review and approve), and direct an exchange to take any action needed to maintain orderly markets whenever it believes that an "emergency," such as market manipulation, exists. 1/

1/ A recent court decision in the case of the March 1979 wheat contract on the CBOT, however, has raised important questions as to the adequacy of the CFTC's authority to require exchanges to take emergency actions.

Potential Benefits from Financial Futures

Futures markets can benefit society by (1) reallocating risk to those more tolerant of it, and (2) aggregating information and making it available to everyone at a low cost. This section will describe how these services are provided by futures markets and examine whether they could be provided just as well without such markets, particularly in the case of financial futures. Also, it will note some of the other uses for financial futures beyond "hedging" and "speculating," as those terms are usually defined in textbooks and in trade literature.

1. Hedging and Speculating

An individual or institution whose business requires holding inventories of any good, finished or in process, may wish to be protected from the risk of adverse price movements of the good in question. A farmer might reasonably feel more competent to grow crops than to forecast their prices. A bank might be better able to assess the credit worthiness of a small business than to gauge what the cost of its own funds will be a year in the future. The farmer might want to protect himself ("hedge") against the risk of unfavorable price changes by locking in now the prices at which he could sell his harvested crop at some later date and the bank might want to hedge against the risk of a rise in the interest rate it must later pay on its CD's. By the same token, individuals who have a preference for risk bearing and who specialize in forecasting prices might be willing to "speculate" by contracting now to buy the yet-to-be-harvested crop or the planned future issue of CD's.

Speculators, however, provide social functions other than relieving hedgers of risk. In order to survive, they must devote substantial resources to the generation of information concerning future events. As they act on this information, they transmit it to the public via the price system. For example, if their private information indicates that the world wheat harvest will be poor, they effectively communicate that information as they bid up the price at which they contract now to buy wheat from farmers at harvest time.

2. Advantages of Futures

The hedging and speculating activities described above could take place even if there were no futures markets. Forward contracts could be negotiated on an individual basis. Or, in the case of the anticipated wheat shortage, speculators could buy wheat from grain elevators and hold these stocks in inventory themselves, thus speculating in the spot market. But futures markets permit these activities to be carried out more efficienctly. The existence of a central market (the exchange) reduces the search costs involved in bringing hedgers and speculators together. The fact that the exchange's clearing corporation interposes itself between the contracting parties further reduces costs by lowering the risk to each side that the other party will default. By publicly providing up-to-the-minute price quotes on all trades, futures markets permit the rapid and widespread dissemination of the information possessed by individual speculators. Finally, purchase of a futures contract does not involve the inventory costs associated with purchase of a commodity in the spot market.

However, these advantages are less important in the case of financial futures. A variety of forward contracts exist, including "when-issued" trades of new securities, standby contracts (put options) on GNMA securities, and repurchase agreements. Hedgers and speculators can be brought together efficiently through the highly developed dealer network. That same network provides for the transmittal of the latest price quotes. Also, financial instruments do not require the storage and transportation costs required for tangible commodities.

Despite the availability of these alternative avenues for hedging and speculating in financial markets, futures trading still has some distinct advantages, such as the role of the exchange as guarantor of every contract. Furthermore, short sales of securities, though possible in the spot market, are cheaper to execute in a futures market since the short does not have to pay a fee to borrow the security. The very fact that financial futures have grown as rapidly as they have in the presence of these alternatives suggests that there are cost advantages to using futures contracts.

Whether financial futures markets increase the availability of information is moot, since the yield curve in the spot market already embodies the views which speculators hold regarding the future course of interest rates. But to the extent that financial futures markets encourage more speculation by lowering the cost of doing so, they also lead to the production of a greater amount of information than would otherwise be available. In other words, while the spot market yield curve may incorporate all available information, that yield curve may itself be altered by the existence of financial futures. There is disagreement among economists, however, as to whether the yield curve will be "improved," i.e., whether it will more accurately anticipate the actual future course of interest rates and whether the additional information generated through futures trading will represent an optimal use of society's resources.

3. Other Uses for Financial Futures

The dichotomy of hedging and speculating fails to capture the variety of motivations for using futures. Even the distinction between hedging and speculating is itself often unclear. For example, the decision to incur the costs of establishing a hedge may reflect one's forecast that prices will move adversely and thus involve an element of speculation. Furthermore, unless the maturity of the futures contract coincides exactly with the time when the crop is harvested or the CD's are issued--to continue the earlier example--a hedged position will not be a riskless one. Nonetheless, hedging does reduce risk exposure, and the fact that there are few "pure hedgers" in the textbook sense operating in financial futures markets need not imply that these markets are not being used to reduce risks.

Financial futures may also be used for arbitrage purposes. An investor may at times find it profitable to, say, sell a 6-month Treasury bill and replace it with a 3-month bill and a tandem 3-month Treasury bill futures contract. Such a trade is "riskless" but it is not "hedging." 1/ On the other hand, one may decide to speculate that the shape of the yield curve will change by taking simultaneous long and short positions in different delivery months for the same security. While such "straddles" are speculative, they typically involve less risk than simple open positions. The riskiness of these and other trades can really be judged only in the context of one's entire portfolio, not in isolation.

1/ It is arbitrage, in that it helps to drive futures and spot market rates into proper alignment and in that the arbitrageur knows his profits with certainty after consummating the trade.

Potential Problems with Financial Futures

The preceding section described some of the uses to which financial futures can be put and some of the benefits--both to individuals and to society at large--which can accrue from these instruments. In order to decide whether the development of financial futures should be encouraged, however, it is necessary to weigh the purported benefits against any potential problems. A variety of such potential problems have been identified. This section attempts to assess their seriousness.

1. The Impact on Spot Markets

A basic concern has been that futures trading in Government securities will have a destabilizing effect on prices in the spot market for these securities and that investors on whom the Treasury normally relies to finance its debt may be dissuaded from bidding in Treasury auctions if prices become less stable, thus leading to higher yields or costs to the Treasury. It is important from a policy perspective to distinguish the case in which destabilizing effects might arise even if futures markets are perfectly competitive from the case in which a small group of investors looms large enough in the markets to have a significant impact on prices.

In the perfectly competitive case, the usual argument for a destabilizing influence from futures goes as follows:

(1) futures trading encourages speculation by reducing the costs involved; (2) speculators are likely to drive futures prices to levels not justified by market fundamentals; (3) wide price swings in futures markets will be transmitted to spot markets via arbitrage. Whatever the intuitive appeal of such reasoning, empirical studies of both agricultural and financial markets have not been able to prove that there is greater price variability in spot markets during periods in which the good or security in question was traded on a futures market.

A supplementary argument (again, in the competitive case) stresses the danger that, should investors be unable to close out futures positions because prices have already moved the daily limit, they may try to cover their positions with offsetting spot market transactions, thereby imparting additional price variability to the spot market. So far, Treasury bill futures prices have never moved their daily limit. Treasury bond futures have done so on a number of occasions, but market participants indicated in interviews that this appeared to be essentially a response to abruptly changed expectations about cash market prices. They did not believe there was any substantial spillover to the spot market from events originating in the futures market.

Still a third possible avenue for futures to have a destabilizing effect on spot prices is by drawing funds into the futures market which would otherwise be used in the spot market. The resulting thinness of the spot market could then make spot prices prone to wider swings. However, since securities dealers generally use the futures markets in conjunction with the spot markets, e.g., for hedging or for arbitrage, their activities should not contribute to any such diversion of funds. Moreover, many of the speculative positions taken by individuals in futures markets would probably have never been taken at all in the cash markets, given the costs of carrying the actual securities.

There is a related concern sometimes expressed that financial futures will divert funds from third markets, particularly the stock market. But buying a futures contract, for which securities in one's portfolio may be pledged as initial margin, does not reduce the volume of funds available to underwrite real investments. In sum, under the assumption of perfectly competitive futures markets, fears that futures trading in financial instruments will disrupt the spot markets have not been documented.

These fears cannot be so lightly dismissed once the competitive assumption is relaxed, however. In speaking of possible ways in which prices (futures or spot) could be distorted, no distinction will be made between a "squeeze" and a "corner." According to the CFTC Glossary, a "corner" means controlling enough of a commodity so that its price can be manipulated, while a "squeeze" refers to a situation in which those who are short cannot repurchase their contracts except at a price substantially higher than the value of the contract in relation to the rest of the market. These definitions are inexact, and do not necessarily have any legal significance.

The possibility of either a corner or a squeeze in the case of the 3-month bill, for example, arises from the fact that the futures contract can be satisfied only with a single maturity, over which command of the available supply is not beyond the resources of a large securities dealer. The "available" supply may be considerably smaller than the total supply to the extent that a substantial portion of each auction goes to the Federal Reserve and to foreign central banks and other noncompetitive bidders who are not likely to be sensitive to price changes in deciding whether to resell. In some auctions during the last year, the Fed and foreign official accounts absorbed all but about $1 billion of the new 3-month issue.

On, say, a $3 billion issue, an individual dealer could take $750 million and still stay within the Treasury guideline of not alloting more than 25 per cent to a single bidder. If, in addition, a dealer also took a sizable long position in the futures market, bought the new 3-month issue on a "when-issued" basis from others bidding or planning to bid in the auction, and had previously acquired a long position in the outstanding deliverable bill (auctioned originally as a 6-month issue), he might well be able to build a long position in the new bill that actually exceeded total auction awards to investors other than the Federal Reserve and foreign official accounts.

Interviews with market participants suggested that dealer positioning strategies of this kind may have succeeded in squeezing the secondary market price on one or two new bill issues during 1978. While market estimates of the resulting distortion in yield in those operations range from 10 to 40 basis points, such judgments cannot be effectively tested, due to the many other special factors that were influencing supply-demand relationships in the cash bill market at the same time. It should be noted, though, that observed spreads among immediately adjacent bill maturities did not widen to these proportions.

The Treasury bond contract differs from the bill contract in that an entire "market-basket" of securities is eligible for delivery. Although the basic trading unit is a bond with a $100,000 face value at maturity and an 8 per cent coupon, any Treasury coupon issue can be delivered if it has at least 15 years to maturity (or to first call). The contract's settlement price is adjusted if other than 8 per cent coupons are delivered.

Possibilities for the manipulation of Treasury bond prices, through joint action in the cash and bond-futures market, appear to be minimal, given the sizable number of issues deliverable under the current contract. While the market-basket approach thus reduces one major potential problem of financial futures, it also reduces one of the major benefits--that is, the uncertainty created as to which issue will ultimately be delivered makes the contract less useful for hedging. In the case of long-term bonds, this problem may be more hypothetical than real, given the flatness of the yield curve at the long end. However, it may pose a problem for the use of the market-basket approach in the intermediate portion of the maturity spectrum, where some of the proposed new contracts fall.

2. Constraints on Treasury

The central point to emerge from the above section is that, in the face of a relatively small deliverable supply of the security specified in a futures contract, the possibility of corners or squeezes leading to disruptive price movements in the spot market is a real one. The Treasury, in turn, could be hurt in the longer run if investors began to shun the market for its debt because of such factors. While the Treasury has the ability to prevent a squeeze by issuing more of the deliverable security, the Treasury should not be so constrained in its debt management decisions by problems in markets for financial futures.

If new contracts were approved for Treasury notes, the chances of problems arising that would make the Treasury feel constrained in its debt management actions might well be increased. Notes are not issued every week as bills are, and the outstanding supply in the proposed contract maturity areas is not as great as for the bond contract. Were there futures contracts on, say, a 4-year note, trading now with maturities extending into 1981, the question would arise whether the Treasury ought to feel obligated to plan to issue such securities two years from now.

An appreciation of the Treasury's need for flexibility in debt management can be gained by considering the different problems which it faces at times of large deficits and of small ones (or of surpluses). With a rapidly expanding debt in recent years, the Treasury shifted from bill financing to regular intermediate note issues to raise new money as it sought to avoid a rapid build-up in the supply of short-term debt, which would have resulted from the combination of deficit financing and shortening of the outstanding debt with the passage of time. A large increase in a bill offering taken to forestall a squeeze in a bill futures contract would be at cross-purposes with this goal. As the rate of growth of the debt shrinks, on the other hand, as budget deficits decline, the Treasury may interrupt or terminate some of its regular offerings in the intermediate note area. In fact, the Treasury interrupted the 5-year note cycle and certain other note issues in recent quarters, because of declining cash needs.

Market participants have generally argued that the Treasury should not feel constrained to tailor its debt offerings to the requirements of futures markets. But the Treasury cannot be unconcerned with the possibly disruptive effects of its actions on the Government securities markets. Whether the Treasury could feel free to ignore the needs of futures markets in making debt management decisions, thus, would depend on (1) how effectively the exchanges meet the requirements of the Commodity Exchange Act and the CFTC guidelines regarding the adequacy of deliverable supply and (2) how futures markets react to such things as abrupt changes in the size of deliverable supplies. A key consideration is the ability of the exchanges to cope with situations of that kind. The exchanges do have specific rules and procedures for dealing with such emergencies, but the question is how aggressively they would implement them.

3. Possible Dangers to Specific Groups of Investors

The bank regulatory agencies must naturally be concerned with the dangers that financial futures might pose for banks which deal in these instruments. There is evidence that financial futures can be used by banks effectively to hedge portions of their portfolios against interest rate risk. The difficulty is in determining whether a given bank's futures position acts to reduce or increase interest rate risk (i.e., whether the position constitutes a hedge or is speculative). Such a determination cannot be made by looking at a futures transaction in isolation, or even by viewing a futures transaction along with a corresponding cash position. Rather the risk of a futures position must be judged against the interest rate risk of the bank as a whole (including the risk of off-balance-sheet commitments) and not relative to any single transaction.

No bank has yet failed or required supervisory attention as a result of involvement in financial futures. However, trading in forward, and standby contracts for GNMA securities has threatened the solvency of some banks, and injudicious trading in commodities futures was the proximate cause of the failure of a foreign banking subsidiary of a large U.S. bank. Caution should be used in drawing inferences based on these experiences. The forward market, which lacks the mark-to-market procedure of futures, allows large gains or losses to accrue without the discipline of daily margin settlements. And the bank failure associated with commodities futures involved a large number of questionable banking practices.

Apart from banks, small investors are another specific group for whom financial futures may cause problems. One fear is that these investors will not distinguish futures contracts on Government securities from the underlying securities themselves.

Additionally, such participants may not recognize that the highly leveraged nature of futures can make them extremely risky. In such circumstances, unsophisticated investors can become especially vulnerable to aggressive, if not ill-advised, selling tactics by brokerage firms promoting futures. While these dangers may be real ones, once again it is important to add that organized futures markets have more built-in safeguards for small investors than do forward markets.

Conclusions and Recommendations

Given the particular concerns that prompted the Treasury/ Federal Reserve study of markets for Treasury futures, the resulting conclusions and recommendations are focussed on three principal issues: (1) the adequacy of deliverable supply for existing and proposed contracts; (2) the problems that might develop from a rapid proliferation of contracts for Treasury securities in general, and of substantially similar contracts on more than one exchange in particular; and (3) the additional safeguards that might be needed to protect the growing number of investors being encouraged to participate in Treasury futures transactions. On each of these issues, recommendations are first listed and then explained.

1. Adequacy of
Deliverable Supply

Proposed new coupon contracts. When reviewing requests for new futures contracts in Treasury coupon issues, it is recommended that the CFTC adhere to the following general guidelines on deliverable supply.

--The CFTC should consider not just the width of the maturity range defining issues eligible for delivery, but also the number of already outstanding issues that will move into that range as the contract approaches delivery, the size of those issues, and their likely availability in the secondary market (as suggested by the length of time they have been outstanding and their distribution by type of holder). These questions should be addressed explicitly in the analysis prepared for the Commission by its staff when new contract designations are being considered. Studies of how the prices of given issues vary relative to those of adjacent issues will help to shed light on this question of availability.

--In no case should the CFTC approve a contract that depends for its deliverable supply solely on a particular security yet to be issued.

--When contracts specify a relatively narrow maturity range for the deliverable supply, approval should also be withheld on new contracts if the deliverable supply of already outstanding maturities consists of only small amounts of closely-held issues.

--To assure that the exchanges regularly review the terms of all outstanding contracts in relation to changes in the structure of marketable Federal debt, the CFTC should reestablish a "sunset" provision for new contracts requiring them to be reviewed and reauthorized every few years.

The IMM has stated that the substantial variability of the Treasury yield curve in the intermediate maturity range would create major market uncertainties concerning the value as a hedge of any new note contract that specified a broad "market-basket" of deliverable supply. For this reason it has restricted the definition of deliverable supply for its proposed 4-year note contract to issues with maturities ranging from only 3-years and 9-months to 4-years and 3-months. While the exchange acknowledges that this relatively narrow band of deliverable maturities might create some risk of an occasional shortage in deliverable supply, it asserts that if such a development should occur, this would not represent a significant problem.

Exchange officials note that they operate under explicit rules for dealing with deliverable supply shortages, are perfectly prepared to use these procedures when needed, and can require settlement of a contract in cash if this becomes necessary. Consequently, they see no reason why an unexpected shortage in deliverable supply should disrupt the cash market, or exert special pressure on the Treasury or the Federal Reserve to deal with the shortage. At the same time, they are concerned that any significant broadening of the deliverable supply for the 4-year note contract would substantially reduce its appeal to investors as an instrument for hedging.

Notwithstanding this IMM contention, the record of commodities exchanges in dealing with deliverable supply shortages in non-financial commodities has been inconsistent. Contracts in Treasury futures pose special problems, since shortages in the deliverable supply can develop with little warning close to the contract delivery date. For example, if an auction of an expected issue were suddenly canceled or substantially reduced in size only a few days before contract delivery, a squeeze on the deliverable supply could develop very unexpectedly. If the deliverable supply were eliminated completely, the exchange would be forced to call for an emergency measure such as settlement in cash. But if the supply were simply reduced significantly below expectations, the exchange and the CFTC might be inclined to temporize, leading to sharp adjustments in cash market rates. In such a situation, the Treasury could be placed in the difficult position of deciding whether to follow through on, or forego, a debt management action which would significantly reduce the deliverable supply of a maturing futures contract.

The risk that squeezes in futures markets might develop and inhibit Treasury debt management flexibility would be reduced if contracts authorized by the CFTC involving delivery of intermediate-term securities were required to adopt a suitable "market-basket" approach to deliverable supply. The fact that some exchanges plan to use this approach on their proposed intermediate-term contracts suggests that they do not see it as a major defect in the contracts.

Existing 1-year bill contract.

--Because its deliverable supply depends wholly on a single new security not yet issued, the existing 1-year bill contract should be modified to assure a broader deliverable supply or, in the alternative, withdrawn.

The existing contract in 1-year Treasury bill futures entails a significant risk of an insufficient deliverable supply because the only issue eligible for delivery is the newly auctioned 1-year bill. Thus, for any given 1-year auction, there is no certainty as to the amount of, or even the issuance of, the bill until about a week before delivery on the futures contract. Any Treasury decision not to roll over, or to reduce significantly the size of the new bill consequently produces an immediate deliverable supply problem, only shortly before the contract delivery date.

The recent postponement of the Treasury's April year-bill auction (necessitated by the Congressional delay in extending the Federal debt ceiling) provided an example of how unforeseen developments can arise shortly before delivery. As a result of that postponement, the IMM was forced to limit trading in the April futures to transactions for closing out positions and to introduce a standby emergency procedure for cash settlement. At the last moment, the Treasury did finally issue the bill, before cash settlement became necessary.

Since trading in the year-bill futures contract has generally been quite light, and the open position in the April maturity was small, the delay in making settlement exerted no evident deleterious effect on the cash market. But the experience did dramatize the extreme vulnerability of any contract that relies for its deliverable supply solely on a security yet to be issued.

The deliverable supply of the 1-year bill contract might be expanded, for example, by making the previous 1-year issue, already outstanding, deliverable as well. However, any broadening of the maturities in the supply base would make the contract somewhat less efficient as an instrument for hedging. With contract months for 3-month bill futures now running beyond one year, it appears that investor needs to hedge against potential changes in short-term rates can be reasonably well accommodated in that more liquid market. Thus, a withdrawal of the 1-year contract would be an alternative resolution of this potential problem.

Existing 3-month bill contract.

--Because the 3-month bill contract has become so well established and so actively used in its present form, a redefinition of deliverable supply at this juncture seems unwarranted.

--However, in view of the concerns expressed by market participants that the 3-month contract has been vulnerable to squeezes under certain conditions, steps should be taken to minimize these possibilities through improved data collection and monitoring of interactions between the futures and cash markets.

Some market participants perceived particular instances where, in their judgment, the deliverable supply for the 3-month bill contract was squeezed. The particular conditions that were cited for creating this possibility were a combination of restricted market supply (resulting from heavy pre-emptive demands in the auction for new 3-month bills from both the Federal Reserve and foreign central banks), and strong interest-inelastic investor demands to hold the deliverable bill (because it fit their particular maturity needs). Although some market participants assert that the margin of interest-sensitive investors willing to sell the deliverable bill and switch to higher yielding alternatives is always sufficient to deter any serious manipulation of bill futures prices, the risk of a squeeze seems real enough to suggest the implementation of additional steps that will further minimize this possibility.

During the month before delivery, the CFTC should routinely collect data on cash and forward positions in the deliverable issue from any entity which has large open positions in the futures contract. The CFTC has already indicated that in special situations, when requested by the Treasury or the Federal Reserve Board, it would be prepared to provide data on a strictly confidential basis showing any large positions in specific futures contracts approaching delivery that are held by Government securities dealers who report to the Federal Reserve. This information will help to supplement the more general data on positions in futures and forwards that the Federal Reserve soon expects to obtain on a daily basis from its reporting dealers. Knowledge that these improved reporting and surveillance procedures are in place should place a further constraint on any major market participant who might otherwise be tempted to try to exert a squeeze on the deliverable supply.

In addition, since the percentage of Treasury bill offerings accounted for by the combination of competitive and private noncompetitive awards has declined significantly in recent years, the Treasury has decided to modify a rule which until now has allowed allotment to a single bidder in a Treasury auction of as much as 25 per cent of the announced amount of the public offering. The new rule will permit a maximum allotment to any single bidder of up to 25 per cent of the combined amounts of the competitive award and the private noncompetitive award. This new base excludes Treasury securities allotted to the Federal Reserve in exchange for maturing securities held both for its own account and for the accounts of foreign official institutions.

Over time this rule modification should broaden the competitiveness of the auction process and contribute to improved distribution of new security issues. The new rule applies to all Treasury security offerings.

The Treasury will also require bidders in its bill auctions to report on the tender form any net long position of more than $200 million taken prior to the auction in the bill being offered. Such a position would include bills acquired through "when-issued" trading and futures and forward transactions, and (in auctions of new 3-month bills) holdings of the outstanding bill (auctioned previously as a 6-month issue) that carry, the same maturity as the new bill. These data will be taken into consideration by the Treasury when awarding new bills in order to reduce the potential for undue concentration and to contribute to improved distribution. This new reporting requirement recognizes the rapid expansion of trading in Treasury bill futures, as well as bill trading on a "when-issued" basis occurring between the announcement and offering dates on auctions.

The alternative of having the Treasury or the Federal Reserve act directly to modify potential squeezes on the deliverable supply of 3-month bills--either through a Treasury increase in the size of the new bill auction, or Federal Reserve sales of the outstanding issue from its portfolio--is not acceptable. While there may be occasions when the Treasury should add to the share of its marketable debt represented by 3-month bills, such actions ought to be taken only as needed to implement the Treasury's general debt management objectives; they should not be initiated to help resolve the particular needs of the commodity exchanges.

Similarily, the Federal Reserve should not be expected to sell 3-month bills from its portfolio to help counter a developing market shortage in the issue deliverable on the maturing bill futures contract. Since the early 1950's the Fed has consistently avoided intervention in the Government securities market for the purpose of adjusting spreads between yields on closely adjacent issues. Earlier experience had shown that any pattern of Federal Reserve market intervention initiated for purposes not clearly seen to be for the implementation of monetary policy tended to create uncertainties about what the System was trying to do, and how its substantial market power would be used to influence prevailing rate relationships. There is a risk that when confronted with such uncertainties dealers and other market professionals will become less willing to take positions in Treasury securities and to operate on reasonable price spreads--thus, reducing the general efficiency of the market.

2. Potential Risks of Contract Proliferation

In view of the differences in self-regulation among the various commodity exchanges and the limited staff resources available to the CFTC for monitoring and surveillance, it is recommended that:

> --The CFTC proceed gradually in authorizing additional contracts for financial futures. In the untested intermediate-term sector, for example, a first step might be to authorize only one note contract, on one exchange, with a range of eligible maturities sufficient to provide a reasonable "market-basket" of deliverable supply. Further, the CFTC should not designate new contract markets on more than one exchange for essentially identical contracts unless it has reached formal agreements with the exchanges involved to provide uniform reporting of positions in such contracts to the CFTC and to establish uniform emergency procedures that would be implemented jointly and coincidently at the request of the CFTC.

A gradual approach would give the CFTC time to enhance its surveillance capacity and would help to demonstrate whether an intermediate note contract, designed conservatively, could elicit an active investor interest without increasing the potential for a squeeze on the deliverable supply.

Even under the best circumstances, the extension of trading in Treasury futures to new maturity sectors and to additional exchanges would require careful, step-by-step implementation and close surveillance of results. In the circumstances that exist, the task appears to be more complicated, since some exchanges have less clearly defined rules than others, and the philosophies with which they implement these rules vary. In addition, for the CFTC to provide the close surveillance that would be required to do an effective job of monitoring additional, essentially duplicative contracts on several exchanges, it would apparently need an expansion of staff with expertise in financial markets.

Uncertainties about the adequacy of deliverable supplies produced by the prospect of contract proliferation are greatest for the proposed intermediate-term contracts, since none of these is yet trading. Nevertheless, pending requests for additional bill contracts also raise similar questions. The proposed AMEX bill contract seeks to minimize competition for deliverable supply with the existing IMM contract by making bills maturing in the first month of the quarter eligible for delivery--rather than those maturing in the third month, as is the case of the IMM contract. However, the IMM in its contract designation has authority to trade additional months. Also, the 3-month and 1-year bill futures contracts being requested by Comex specify issues for delivery that would be substantially overlapping with the existing IMM contracts.

It can be argued, in principle, that the combined demands for delivery generated by several overlapping futures contracts will not be significantly greater than those generated where only a single contract is being offered. But it seems more likely that a proliferation of contracts would lead, in practice, to enlarged total demands for delivery. In their requests for additional contracts, the exchanges seeking CFTC approval of overlapping contracts have asserted that they do not believe a proliferation would diminish trading volume on existing exchanges, since they expect their marketing and promotional activities to expand overall demand.

A larger demand for deliveries would mean that there would be a correspondingly larger volume of short positions outstanding just prior to delivery date. This might in turn be viewed as an added potential for profiting from a market squeeze, particularly if market participants thought they could build up a relatively large long position on several exchanges, without attracting the same attention that a similar total position would attract if it were concentrated on a single exchange. To guard against this possibility the CFTC, before permitting contract proliferation should have in place procedures that assure regular checking of positions being taken by particular operators on more than one exchange. This may require reporting of smaller position totals on single exchanges than is now the case.

If the CFTC were to authorize essentially similar contracts on several exchanges at about the same time, it would be important to assure that consolidated position data reported from these exchanges was carefully evaluated, and that, in cases where emergency procedures had to be implemented, identical procedures were implemented on each exchange at the same time. There can be no assurance that exchanges will respond to a given emergency in a coordinated manner unless the CFTC by written agreement is authorized to require such action. Specifically, the CFTC should specify by agreement with the relevant exchanges identical emergency procedures for essentially comparable contracts--including rights of substitution, changes in margin and other measures to encourage a liquidation of open interest, and, if need be, a suspension of trading. Such procedures should also be given greater publicity, so that market participants could gain a better understanding of them. This would also avoid a competitive devaluation of self-regulatory standards.

3. Safeguards for Investors

In view of the rapid growth in Treasury futures and the potential for widespread participation by individual investors:

--Further study of investor protection and exchange regulation being conducted jointly by the CFTC, the Treasury, and the Securities and Exchange Commission should proceed. Among the issues to be explored should be appropriate customer suitability standards, margin requirements, and position limits.

--In addition, the CFTC and the exchanges promoting futures contracts should make clear that futures contracts based on Government securities are not obligations of the U. S. Treasury. To avoid any confusion on this question, the exchanges should not use pictures of the Treasury building or of Treasury securities in their promotional material.

The posting of margin and daily marking to market are important aspects of futures exchanges that are designed to protect all participants. Such safeguards substantially reduce the credit risks associated with transactions for future delivery, are helpful in encouraging good management control, and significantly reduce the likelihood that harmful situations will develop. Unfortunately, however, the existing reporting system on particular transactions does not appear sufficient to preclude unethical practices from occasionally occuring within a trading day. Serial tapes, which record the prices and quantities of all transactions as they occur, would help to eliminate the potential for such abuse. Hence the CFTC should continue to encourage the use of serial tapes by the exchanges.

As existing contract markets for Treasury futures expand and additional contracts are offered, it seems quite likely that a growing range of participants will be attracted to these markets--some of whom may not have particularly strong financial positions. Existing safeguards and procedures, including the taking of margin and daily marking to market, appear to afford adequate protection for those involved in most cases. However, although clearing members are required by the exchanges to post margins and mark-to-market, they are not required to use uniform margin and marking-to-market procedures for their own customers. Thus, in some cases, individual customers and/or clearing members may be exposed to undue risk.

Some firms, have, nevertheless, established customer suitability standards of their own and have required considerably larger margin on certain types of accounts for which they undertake transactions. Additional efforts in this direction--and perhaps the development of more formal suitability standards--should be encouraged.

Some participants have indicated that they were contacted by over-zealous representatives of firms that were active in the marketing of futures who appeared to have an insufficient understanding of futures transactions. At present this does not appear to be a serious problem, and it is an expected outcome when one market is expanding rapidly at a time when profitability and employment in other financial markets have been steady or shrinking. It does seem appropriate, however, for the CFTC and the exchanges to explore approaches that could strengthen the surveillance of smaller dealer firms. Periodic reviews of general sales and marketing techniques could also prove beneficial. And it seems appropriate for the CFTC and the exchanges to undertake a program that would inform the public about the risks associated with such highly leveraged transactions, since these may not be sufficiently emphasized by private firms and individual salespersons. Such a program would also be helpful in clarifying emergency procedures and reasons for their possible implementation.

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FOR IMMEDIATE RELEASE

REMARKS BY
THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE
THE NEW YORK STATE BANKERS ASSOCIATION
WASHINGTON, D.C.
MAY 15, 1979 -- 12:30 P.M.

I am pleased to have this opportunity to speak to you today. Your annual visit to Washington is always a welcome event, for it provides a chance to exchange views on the issues of the day -- and there is no dearth of issues to discuss today. They grow in number, significance and complexity each year. Each suggested change in the established order of banking tends to challenge something else in the order. Thus one industry group argues for greater freedom to expand and compete; that conflicts with another industry group that argues for the preservation of the status quo amid claims of unfair competition. Meanwhile, one consumer group presses for greater protection for its members, while another asks that a greater return be permitted on its investment in the system. Thus, it is not unusual for an issue in the regulated environment of banking to become a three- or four-way contest among those with inconsistent claims upon the system. A number of issues of that type have been carried over unresolved from last year, even though last year produced a prodigious amount of banking legislation.

The House Banking Committee has already turned to a major piece of unfinished business from last year: the Federal Reserve membership issue. Unfortunately, the prospects for agreement on this important issue remain cloudy, but we shall hear more of it even as the House turns its attention to other banking issues.

Mr. St Germain's subcommittee has set hearings this month on the question of restricting bank holding company activities and on the question of bank underwriting of revenue bonds, issues carried over from the last session. In addition, there are some new issues that the subcommittee hopes to address. The recent decision of the U.S. Court of Appeals for the District of Columbia invalidating the automatic transfer program inaugurated by the regulators and the credit union share draft has inspired the Congress to consider these questions directly. Similarly, various members of Congress have expressed interest in reviewing the federal regulators' new "small saver" proposals.

The Treasury has a role to play in the debates surrounding these and other banking issues. From my perspective, that role is to provide the long and the broad view on the endless succession of financial issues. That may sound a bit Olympian coming from anyone in Washington -- where 180° changes in course are an established strategem -- but we can no longer afford the luxury, if ever we could, of addressing change solely through the resolution of short-term conflicts. Consideration of long-term costs and orderly evolution are vital to our economic health.

If the history of the last decade or so suggests anything, it is that we have not been keenly enough aware of the long-term inflationary impact of legislative decisions. This Administration has been laboring for two years -- in the footsteps of its predecessors -- to contain the course of inflation, and in that process we have learned something of the frustration that comes from trying to address a problem that has been years in the making. One thing is very clear: inflation is a long-term problem -- that requires a long-term solution; or, more accurately, a long-term set of solutions.

An historian friend told me a few weeks ago to take solace from the knowledge that inflation has traditionally been a heavy burden and not easily dealt with. He pointed out that Lord Treasurer Weston, whom King Charles I appointed in 1630, had a particularly uninspiring record. At one of his first meetings as a member of the English Privy Council, Weston's attention was drawn to an octogenarian servant of the crown who was in dire distress. His name was Julius Caesar. This Caesar had been granted a pension by Queen Elizabeth in 1600, but now in 1630 inflation had reduced its purchasing power by about two-thirds. Something must be done for Caesar, Weston's colleagues told him.

Weston took note of the matter by scribbling the words "Remember Caesar" on a piece of paper which he stuck in his pants pocket as a reminder. But on reaching home he changed his trousers, and it was not for several weeks that he again put on those he had worn at the Council meeting. By that time he had forgotten about the poor pensioner. "What could the reminder mean?" he asked himself. With a shock he realized that the Ides of March were upon him. His predecessor, Buckingham, had been assassinated. So Weston took prompt action and had a guard posted around his house.

I trust that this Administration has been more successful in identifying inflationary problems than was the Lord Treasurer Weston, but the results thus far suggest that this nation is far from a permanent solution. Recent figures continue to be disheartening.

The rate of advance in prices in recent months is running far above acceptable levels. Consumer prices rose over the first three months of 1979, at an annual rate of 13 percent. This compares with a 9 percent rise in 1978 and just under 7 percent during 1977.

In part, the recent bad news on the inflation front reflects unfavorable developments in farm and food prices. But acceleration has also been taking place across a broad range of other prices. Home ownership costs, apparel prices, automobile prices, wholesale prices and prices for intermediate and crude materials -- all have been rising at an increasing rate. It is not unlikely that there will be more bad price news in the months to come.

We do expect some abatement in the rate of inflation this year, but we also recognize that a significant and enduring reduction in the inflation rate requires persistent application of restraint. There is just no quick cure for an inflation that has been building for over a decade and that has woven itself into the economic and social fabric of our society. As you know, this Administration is committed to budgetary restraint as one of the best tools available for curbing inflation. The austere budget for

FY 1980 proposed by the President will reduce the Federal Government's share of demand placed on our physical and financial resources. This will help to limit the possibility of a resurgence in aggregate demand. This fiscal restraint accompanied by monetary restraint is a necessary environment for the program of voluntary wage/price guidelines for both labor and industry.

This Administration has also focused on a goal that should be of particular interest to you. It is the goal of reducing the cost and complexity of regulation. As I suggested earlier, the Federal Government has for many years been making decisions about the structure, form and behavior of regulated industries with little systematic appreciation for the long-term real costs involved. That is changing.

The clearest evidence of this change can be found in the recent trend toward deregulation of industries that have grown up under the protective umbrella of regulation. The airlines, trucking and telecommunications industries are examples. At the same time there is a trend toward reducing the costs of regulation where regulation is accepted as a necessary element in an industry. We will see more of both trends in the area of regulated financial institutions.

Market forces as well as regulatory initiatives have begun to erode the artificial barriers to competition that have insulated many financial institutions. To be sure, the regulators have suffered some judicial reverses in their efforts to remove competitive restrictions on financial institutions, most notably the recent decision invalidating automatic transfers. If not reversed on appeal, Congress must address the consequences of that decision. While I do not underestimate the difficulties of legislating a response, I am heartened by the fact that market forces are creating their own imperatives for change. This is true not only for the prohibition of payment of interest on demand deposits, but also for deposit interest rate ceilings generally.

The spectacular growth of money market mutual funds and the advent of cash management accounts with check writing privileges, such as that offered by Merrill Lynch, mean that financial institutions can no longer operate in the closed environment of rigidly regulated ceilings. These thoughts have been reflected in some of the recommendations that the Regulation Q Task Force has sent to the President. While I cannot predict what the President's actions on the recommendations will be, I do feel confident that the trend toward dismantling economic regulation in this area will continue.

This is not to suggest that banking can be completely deregulated. The lessons of history underline the importance of the solvency and soundness of our banks and mandate continuance of significant restrictions. And the trend in recent years toward regulation of a social character may also continue. The Truth-in-Lending Act, the Community Reinvestment Act, and the proposed financial privacy bills attest to an abiding Congressional concern for the consumer and the community. These are bipartisan concerns that are not likely to be reversed. But the trend is toward closer examination of the process, and my suggestion to you is to involve yourselves fully in this process. It is too late to cite the costs and difficulties of implementing legislation after it is on the books. Detailed analysis of a bill must begin at the outset of the process. You must provide the Congress in advance with the information necessary to make an informed judgment on the costs and benefits of these proposals.

There is one recent example that makes this point dramatically. As part of the omnibus bank bill last year, Congress enacted a privacy provision regulating access by federal government agents to bank records. The Treasury was deeply involved in the drafting of these provisions. We sought to minimize their impact by providing for reimbursement to the banks and by limiting possible civil liability of banks to their clients. At the same time, we argued against a provision that would require banks to provide a one-time notice under the Act to their present and past customers. We were unsuccessful, and the Congress enacted a bill with this provision. Only after the bill had been signed into law, did the banking industry develop estimates that it might cost as much as a billion dollars to comply with this provision. When presented with this information, the Congress acted quickly to remove the provision through separate legislation. I wish I were sure that there are not other costly provisions in the bill where the results are less dramatic and where modification now will prove less tractable.

The regulators also must play a part in containing the burden of regulation. Duplicative and excessive regulation are needless costs. We must urge the regulators to exercise their discretion, wherever possible, to minimize the regulatory burden. The banking bill of last year has provided us with an important institutional mechanism to aid this effort. The bill calls for a Financial Institutions Examination Council, the mandate of which is to achieve uniformity in the examination and supervisory process. I trust you will do your part in urging the regulators to take the opportunity presented by the Council to produce a system that is as cost effective and efficient as possible.

There are other efforts also being made to achieve greater efficiency in the regulatory sphere. The Regulatory Council, as established by a Presidential Directive, represents a more comprehensive attempt to order the regulatory process. The Council consists of most Executive Branch agencies with regulatory powers as well as many of the independent agencies such as the Federal Reserve Board and the FDIC. Besides publishing the semi-annual calendar of proposed major regulations, the Council is investigating areas where duplication and overlap exist in regulatory schemes. The Council is now considering several projects that will bring it squarely into the area of bank regulation.

As a further measure the Administration has proposed a regulatory reform bill which would, among other things, require all agencies, including independent agencies, to do a cost-benefit analysis of proposed major regulations. It would further require those agencies to choose the least costly alternative or explain why a more costly alternative was selected. Several other proposals, with language generally weaker than that of the Administration's bill, have been offered in the Congress. The fate of these bills is uncertain. Your voices ought to be heard in the debates in which the issues will be resolved.

There is work sufficient for all of us in improving our regulatory system. In the most fundamental sense, this is simply the task of making government work. As such, we all have a stake in this effort--and we will all stand to be winners if it succeeds.

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

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FOR IMMEDIATE RELEASE
May 15, 1979

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TREASURY ANNOUNCES THIRD-QUARTER
1979 TRIGGER PRICES

The Treasury Department today announced a decrease of 1.4 percent in trigger price bases and extras for the major steel mill products covered by the Trigger Price Mechanism (TPM). Treasury also announced a slight increase in the freight component of the trigger price.

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 carry out 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. For the second quarter, the band was used to maintain trigger prices at their first-quarter levels, 1.2 percent above estimated production costs. For the third quarter, 1.8 percent of the band is used to reduce the 3.2 percent decrease in trigger prices dictated by the current cost estimates to a 1.4 percent decrease.

The third-quarter production cost estimates are based on Treasury Department monitoring of Japanese costs, including recent cost submissions from Japan's Ministry of International Trade and Industry. The third-quarter cost estimate reflects a 212 yen/dollar exchange rate (the average for the period March 5 through May 4), applied to the yen-denominated production costs. For the second quarter a 197 yen/dollar exchange rate was used (the average for the period December 11 through February 9).

For the major steel mill products, the average cost of production per net ton of finished product is estimated to be $341.08, 3.2 percent lower than the average second-quarter trigger price level.

B-1605

For products produced by the electric furnace companies, third-quarter trigger prices will increase by amounts varying from 1.6 percent to 2.5 percent, depending on the product. The prices reflect an update of costs, which included about a 15 percent increase in the cost of scrap, the yen depreciation, and use of 1.8 percent of the flexibility band. Treasury's estimate of the production costs of the electric furnace products ranged from 0.2 percent below to 0.7 percent above second-quarter trigger price levels.

The trigger base prices and extras of stainless steel wire will decrease 6.2 percent reflecting production costs which are 8.0 percent below the second-quarter trigger price levels and the use of 1.8 percent of the flexibility band.

TPM freight rates will increase, principally because of increases in fuel costs to Japanese shippers. All TPM freight rates will increase $1 for steel mill products entering West Coast ports and $2 for each of the other port areas.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

NOTICE

Imported Steel Mill Products Trigger Price Mechanism: Third-Quarter 1979 Revision of Trigger Prices

The Treasury Department hereby announces steel mill product trigger prices for the third 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 accordingly.

Third-quarter trigger base prices and extras for steel mill products of the integrated steel producers, which account for about 90 percent of U.S. steel mill product imports, are 1.4 percent lower than their second quarter levels.

The cost estimates for the third quarter, on which trigger prices are based, are calculated using a 212 yen/dollar exchange rate (whereas the second quarter cost estimates are based on a 197 yen/dollar exchange rate). The resulting decrease in Japanese steel production costs is partially offset by increases in the cost of raw materials and labor.

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 the first quarter of 1979 to establish trigger prices at 3 percent below Treasury's estimate of production cost, which had increased 10 percent. In the second quarter, the band was used to maintain trigger prices at their first-quarter levels, or 1.2 percent above the production costs estimated for the second quarter. For the third quarter, 1.8 percent of the flexibility band is used to reduce the 3.2 percent decrease in trigger prices dictated by the current cost estimates to a 1.4 percent decrease.

The trigger base prices and extras of the steel mill products of the electric furnace producers will increase by 2.5 percent for Group A products, 2.2 percent for Group B products, and 1.6 percent for Group C products.1/ These prices reflect cost increases of 0.1 percent and 0.4 percent for Group A and Group B products, a cost decrease of 0.1 percent for Group C products, and the use of 1.8 percent of the flexibility band for each of these three groups.

1/See Table 2 for a listing of which products are included in each of Groups A, B and C.

The trigger base prices and extras of stainless steel wire will decrease 6.2 percent reflecting production costs which are 8.0 percent below the second-quarter trigger price levels and the use of 1.8 percent of the flexibility band.

I. <u>Integrated Producers</u>

To determine third-quarter trigger price levels, Treasury estimated the dollar cost of producing steel in Japan using a 212 yen/dollar exchange rate. The 212 yen/dollar rate is the average rate for the period March 5 through May 4, 1979, the two-month period immediately preceding the calculation of third-quarter trigger prices. The 212 yen/dollar exchange rate compares to the 197 yen/dollar exchange rate used for second quarter estimates of production costs, and by itself would have caused approximately a $19, or 5 percent, decrease in the cost estimate.

However, the price Japanese steel producers must pay for raw materials and labor has substantially increased and offset by $11, or 2.8 percent, the effect of the yen's depreciation. Forty percent of the cost increase in raw materials results from increases in the prices of coal and fuel oil, and most of the other 60 percent reflects an increase in the price of iron ore. Labor costs increased 5 percent reflecting Japanese steel industry's 1979 wage settlement with the labor unions.

As shown in Table 1 below, the combined effect of the yen's depreciation and the increase in the price of raw materials and labor is an $8 decrease in the cost per metric ton of finished steel mill products ($7 per net ton).

The resulting base prices for products produced by integrated producers are shown in Table 3.

II. <u>Electric Furnace Products</u>

Treasury estimated the costs of producing electric furnace products for the third-quarter trigger prices based on a recent cost submission from Japan's Ministry of International Trade and Industry (MITI) and a 212 yen/dollar exchange rate. The MITI submission on electric furnace products completely updates the information MITI had previously provided on electric furnace production costs.

Other than the exchange rate change, the only cost change having a major impact on the production costs of these products is a 15 percent increase in the cost of scrap.2/ Scrap currently

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2/In the United States, the price of steel scrap for export has risen more dramatically in recent months. However, U.S.-originated steel scrap accounts for less than 10 percent of the scrap needs of the Japanese electric furnace mills. The overall rise of scrap cost to the Japanese electric furnace producers has thus been more moderate.

TABLE 1. Japanese Production Cost Estimates
Integrated Steel Producers

Second and Third Quarters, 1979
(U.S. dollars per ton of finished product)

	Second Quarter (197 ¥/$)	Third Quarter (212 ¥/$)
Basic Raw Materials	$119.03	$124.68
Other Raw Materials	72.21	67.10
Labor	94.07	91.80
Other Expenses	28.65	26.62
Depreciation	29.72	27.62
Interest	25.96	24.12
Profit 1/	25.12	24.82
Yield Credit	(10.82)	(10.79)
Total Cost $/MT	$383.94	$375.97
Total Cost $/NT	$348.31	$341.08

1/Profit = .08 (Raw materials plus labor plus other expenses).

accounts for about half of the cost of these products. Other cost changes with less impact include a negotiated increase in labor wages of 3.2 percent with offsetting decreases in labor usage rates, increased charges for electricity and fuel oil, and generally decreased interest cost due to lower debt levels. Table 2 below shows, for electric furnace products, second and third quarter estimated production costs per metric ton by cost element and total estimated cost per net ton.

The resulting base prices for products produced by electric furnace producers are shown in Table 3.

III. Stainless Steel Wire

Treasury adjusted its estimate of Japanese stainless production costs to a 212 yen/dollar exchange rate base. This results in a roughly 8 percent cost reduction. Japanese stainless steel production costs are 100 percent yen-denominated (the production costs of integrated producers are only about two-thirds yen-denominated); hence, changes in the dollar-value of Japanese stainless steel production costs approximately equal changes in the yen/dollar ratio.

Stainless steel wire trigger prices were first published only in January 16, 1979, after an extensive Treasury study; consequently, the input prices used to estimate stainless steel production costs are still current and no cost adjustments, other than the exchange rate adjustment, are necessary.

The resulting base prices for stainless steel wire are shown in Table 3.

IV. Freight

MITI also submitted an update of freight costs from Japan to the United States. Principally because of increases in fuel costs to Japanese shippers, TPM freight rates will increase. All TPM freight rates will increase \$1 for steel mill products entering West Coast ports and \$2 for each of the other port areas.

TABLE 2

Japanese Production Cost Estimates: Electric Furnace Products

Second and Third Quarter 1979

(U.S. dollars per metric ton of finished product)

	Group A[1]		Group B[2]		Group C[3]	
	Second Quarter	Third Quarter	Second Quarter	Third Quarter	Second Quarter	Third Quarter
Basic Raw Materials	$157.81	$168.08	$169.92	$182.82	$156.74	$168.52
Other Raw Materials	34.76	33.72	41.08	36.34	37.55	33.13
Labor	30.80	28.17	35.05	30.74	24.56	22.28
Other Expenses	12.25	11.20	14.96	17.23	15.45	13.55
Depreciation	6.67	7.00	8.48	9.65	6.82	6.34
Interest	7.47	6.33	10.69	7.25	6.86	6.35
Profit[4]	18.85	19.29	20.88	21.37	18.74	19.00
Scrap Credit	(2.83)	(2.93)	(3.19)	(2.51)	(2.79)	(2.68)
Total $/MT	$265.78	$270.86	$297.87	$302.89	$263.93	$266.49
Total $/NT	$241.11	$245.72	$270.23	$274.78	$239.44	$241.76

1/ Group A products are equal angles, unequal angles, channels, and I-beams.

2/ Group B products are hot rolled strip from bar mills; merchant quality flat 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).

PRODUCT BASE PRICES FOR SHIPMENTS EXPORTED DURING THIRD QUARTER 1979
(All Base Prices Decreased 1.4% Unless Otherwise Noted)

Page */	Product	Second Quarter 1979 Base Price ($/Metric Ton)	Third Quarter 1979 Base Price ($/Metric Ton)
2-1	Wire Rods Commercial Quality AISI 1008 5.5mm	315	311
2-2	Wire Rods Welding Quality AISI 1008	316	312
2-3	Wire Rods High Carbon AISI 1065 5.5 mm	366	361
2-5	Wire Rods Cold Heading Quality AISI 1038 12.7 mm	378	373
2-7	Wire Rods Cold Finished Bar Quality	378	373
2-9	Spheroidized Annealed Mo Alloy Steel Wire Rod AISI 4037 5.5 mm to 13 mm	552	544
2-13	Spheroidized Annealed Si-Mn-Cr High Carbon Steel Wire Rod AISI 52100 5.5 mm to 13 mm	529	522
2-15	Spheroidized Annealed High Carbon Cr Steel Wire Rod AISI 52100 5.5 mm to 13 mm	607	599
3-1	Wide Flange Beams and Bearing Piling ASTM A-36 12" x 12"	306	302
3-4	Standard Carbon Steel Channels ASTM A-36 **	274	281
3-6	Unequal Leg Carbon Steel Angles ASTM A-36 **	288	295
3-8	Equal Leg Carbon Steel Angles ASTM A-36 **	259	265
3-10	Standard Carbon Steel "I" Beams ASTM A-36 **	315	323
4-1	Sheet Piling ASTM A-328 Arch Web PDA-27	346	341
5-1	Steel Plates ASTM A-36 1/2" x 80" x 240"	316	312
6-1	Heavy Carbon Steel Rails AREA 115, 132 or 136	352	347
6-3	Light Rails 60 lbs./yd.	346	341
6-5	Tie Plates	353	348
8-1	Plain and Deformed Carbon Steel Concrete Reinforcing Bars ASTM A-615 ****	255	259
9-1	Hot Rolled Carbon Steel Bar Size Channel ASTM A-36 ***	381	389

*/ Page references are to the First and Second Quarter Trigger Price Manual published by the Department of the Treasury, April, 1979. The first figure of each page reference corresponds to the AISI product category of that product.
**/ Electric Furnace, Group A. The increase from Second to Third Quarter is 2.5%.
***/ Electric Furnace, Group B. The increase from Second to Third Quarter is 2.2%.
****/Electric Furnace Group C. The increase from Second to Third Quarter is 1.6%.

Table 3 (Continued)

Page */	Product	Second Quarter 1979 Base Price ($/Metric Ton)	Third Quarter 1979 Base Price ($/Metric Ton)
10-1	Rolled Carbon Bars Special Quality AISI 1045 40 mm round x 4 meters	402	396
10-3	Merchant Quality Hot Rolled Carbon Steel Squares and Round Cornered Squares ASTM-36 or AISI 1020 ***	318	325
10-5	Merchant Quality Hot Rolled Carbon Steel Round Bar ASTM A-36 or AISI 1020 ***	318	325
10-7	Merchant Quality Carbon Steel Flat Bars ASTM A-36 or AISI 1020 ***	289	295
11-1	Hot Rolled Ni-Cr-Mo Alloy Steel Round Bar AISI 8620 40 mm	463	457
11-6	Spheroidize Annealed High Carbon Cr Steel Round Bar AISI 52100 40 mm to 100 mm	517	510
12-1	Cold Finished Carbon Steel Round Bar AISI 1008 through 1029 10.05 mm (3/4")	464	458
12-2	Cold Finished Round Steel Bar (Free Cutting Steel-Sulfur) AISI 1212 through 1215, 19.05mm (3/4")	524	517
12-3	Cold Finished Round Steel Bar (Free Cutting Steel-Lead) AISI 12L14 and 12L15 19.05 mm (3/4")	550	542
12-5	Cold Finished, Ni-Cr-Mo Alloy Steel Round Bar AISI 8620, 40 mm	463	457
12-7	Cold Finished Spheroidized Annealed, High Carbon Cr Steel Round Bar, AISI 52100, 50100, 51100	517	510
14-1	Electric Resistance Welded Carbon Steel Pressure Tubing for use in Boilers, Heat Exchangers, Condensers, Etc.	517	510
14-6	Continuous Butt Welded Standard Pipe	350	345
14-8	Electric Resistance Welded Pipe, Excluding Oil Well Casing, Without Coupling	368	363
14-13	Submerged Arc Welded Pipe	446	440
14-16	Electric Resistance Welded Structural Tubing to ASTM A-500 Grades A, B & C	385	380
14-22	Electric Resistance Welded Standard Pipe ASTM A-120 (A-53)	355	350

*/ Page references are to the First and Second Quarter Trigger Price Manual published by the Department of the Treasury, April, 1979. The first figure of each page reference corresponds to the AISI product category of that product.

***/ Electric Furnace, Group B. The Increase from Second to Third Quarter is 2.2%.

Page */	Product	Second Quarter 1979 Base Price ($/Metric Ton)	Third Quarter 1979 Base Price ($/Metric Ton)
14-24	Electric Resistance Welded Standard Pipe ASTM A-120 (Larger Sizes)	355	350
14-26	Piling Pipe ASTM A-252	347	342
14-30	Electric Resistance Welded Hot Dipped Galvanized Fence Pipe and Tubing in Plain Ends	355	350
14-32	ERW Mechanical Tubing ASTM A-513	464	458
15-1	Seamless Carbon Steel Oil Well Casing, Not Threaded, up to 7" in Outside Diameter	435	429
15-4	Seamless Carbon Steel Oil Well Casing, Not Threaded, 7 inches and over in Outside Diameter	431	425
15-7	Seamless Carbon Steel Oil Well Casing, Threaded and Coupled, 7 Inches and over in Outside Diameter	489	482
15-10	Seamless Carbon Steel Oil Well Casing, Threaded and Coupled, up to 7 Inches in Outside Diameter	494	487
15-13	Electric Resistance Welded Carbon Steel Oil Well Casing, Not Threaded	388	383
15-15	Electric Resistance Welded Carbon Steel Oil Well Casing, Threaded	458	452
15-17	Seamless Carbon Steel Pressure Tubing Suitable for use in Boilers, Superheaters, Heat Exchangers, Condensers, Refining Furnaces, Feed Water Heaters, Cold Finish	831	819
15-43	Seamless Carbon Steel Oil Well Tubing EUE With Threading and Coupling	651	642
15-45	Seamless Carbon Steel Line Pipe	443	437
15-48	Hot Rolled High Carbon Cr Steel Tube Suitable for Use in Manufacture of Ball or Roller Bearings AISI 52100 60 mm to 100 mm	631	622
15-49	Cold Rolled High Carbon Cr Steel Tube Suitable for Use in Manufacture of Ball or Roller Bearings AISI 52100 60 mm to 100 mm	938	925
15-50	Seamless Stainless Steel Round Ornamental Tube AISI TP 304, 1 1/4 x 0.049"	2128	2098
15-52	Seamless Stainless Steel Square Ornamental Tube AISI TP 304, 1 1/2 x 1 1/2 x 0.065"	2319	2287

*/ Page references are to the First and Second Quarter Trigger Price Manual published by the Department of the Treasury, April, 1979,. The first figure of each page reference corresponds to the AISI product category of that product.

Table 3 (Continued)

Page */	Product	Second Quarter 1979 Base Price ($/Metric Ton)	Third Quarter 1979 Base Price ($/Metric Ton)
16-1	Cold Heading Round Wire AISI 1018 Killed 0.192" Hard Drawn	474	467
16-1	Cold Heading Drawn from Annealed Rods	538	530
16-1	Cold Heading Drawn from Spheroidized Annealed Rods	550	542
16-1	Cold Heading Anneal in Process	554	546
16-1	Cold Heading Spheroidize Anneal in Process	564	556
16-1	Cold Heading Anneal in Process and Drawn from Annealed Rods	597	589
16-1	Cold Heading Spheroidize Anneal in Process and Drawn from Annealed Rods	607	599
16-1	Cold Heading Anneal at Finish Size	538	530
16-1	Cold Heading Spheroidize Anneal at Finish Size	550	542
16-1	Cold Heading Anneal at Finished Size and Drawn from Annealed Rods	580	572
16-1	Cold Heading Spheroidize Anneal at Finished Size and Drawn from Annealed Rods	593	585
16-4	Bright Basic Round Wire AISI 1008 #8 Gauge Rimmed	389	384
16-5	Galvanized Iron Round Wise AISI Type I Coating #8 Gauge	490	483
16-8	Round Baling Wire 14.50	544	536
16-9	Cold Finished Spheroidized Annealed, Si-Mn-Cr High Carbon Steel Wire AISI 9254	529	522
16-11	Cold Finished Spheroidized Annealed Mo Alloy Steel Wire AISI 4037, 5.5 mm to 13 mm	552	544
16-13	High Carbon Cr Steel Wire in Coil AISI 52100, 50100, 51100, Suitable for use in manufacture of ball or roller bearings.	826	814
16-15	Upholstery Spring Wire Automatic Coiling and Knotting Type	487	480
16-16	Mechanical Spring Wire ASTM A-227 and A-648	513	506
16-17	Oil Tempered Steel Spring Wire ASTM A-229	516	509

*/ Page references are to the First and Second Quarter Trigger Price Manual published by the Department of the Treasury, April, 1979. The first figure of each page reference corresponds to the AISI product category of that product.

Table 3 (Continued)

Page */	Product	Second Quarter 1979 Base Price ($/Metric Ton)	Third Quarter 1979 Base Price ($/Metric Ton)
16-18	Carbon Steel Valve Spring Quality Wire ASTM A-230	859	847
16-19	Automobile Tire Bead Wire	602	594
16-20	Galvanized Core Wire for A.C.S.R. ASTM B 498 Class "A"	642	633
16-21	Stainless Steel Annealed Wire Grade 301 ****	2073	1944
16-25	Stainless Steel Hard/Spring Wire Grade 301 ****	2073	1944
16-28	Stainless Steel Soft/Intermediate Wire Grade 301 ****	2073	1944
19-1	Field Fence	587	579
20-1	Wire Nails Bright Common 20d # 6 13/32 x 4"	454	448
21-1	Barbed Wire 2 Ply, 12.50	618	609
22-1	Black Plate ASTM A625-76 0.0083" x 34" x Coil	407	401
23-1	Electrolytic Tin Plate SR-25/25 75L x 34" x C	551	543
25-1	Hot Rolled Steel Sheets ASTM A-569 0.121" x 48" x Coil	280	276
25-2	Hot Rolled Steel Band ASTM 569 0.121" x 48" x Coil	268	264
26-1	Electrical Steel Sheets Grain Oriented M-4 0.012" x 33" x C	1183	1166
26-3	Electrical Steel Sheets Non Oriented M-45 0.018" x 36" x C	638	629
26-5	Cold Rolled Sheets ASTM A-366 1.0 m/m x 48" x C	351	346
27-1	Electro Galvanized Sheets EGC 10g/M^2 1.0 m/m x 48" x C	415	409
27-4	Galvanized Sheet ASTM A525G90 0.8 m/m x 48" x C	417	411
29-1	Hot Rolled Carbon Steel Strip Produced on Bar Mills Cut Lengths ***	323	330
29-3	Hot Rolled Carbon Steel Strip Produced on Sheet Mills Coils Only	274	270
32-1	Tin Free Steel Sheets SR 75L x 34" x C	472	465

*/ Page references are to the First and Second Quarter Trigger Price Manual published by the Department of the Treasury, April, 1979. The first figure of each page reference corresponds to the AISI product category of that product.

***/ Electric Furnace, Group B. The increase from Second to Third Quarter is 2.2%.

****/Stainless steel wire. The decrease from Second to Third Quarter is 6.2%.

Robert H. Mundheim
General Counsel

Dated: MAY 1 6 1979

Part II

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

NOTICE

New and Adjusted
Trigger Base Prices and "Extras"
for Imported Steel Mill Products

I am hereby announcing (1) new trigger base prices and "extras" for products not previously covered by the Trigger Price Mechanism and (2) adjustments to, and additional "extras" for products for which trigger prices have been previously announced. Attachment 1 lists the specific product involved and describes the action being taken. These trigger prices will be used by the Treasury Department in monitoring imports of these products under the trigger price mechanism. Accordingly, a number of pages in the Steel Trigger Price Handbook are being reissued to reflect these actions.

Description of the trigger price mechanism may be found in the "Background" to the proposed rulemaking (42 F.R. 65214) and the final rulemaking (43 F.R. 6065) which amended regulations to require the filing of a Special Summary Steel Invoice (SSSI) with all entries of imported steel mill products.

These base prices, and extras, and adjustments are based upon information made available to the Treasury Department by the Japanese Ministry of International Trade and Industry (MITI), as well as other information available to the Department.

The trigger prices published on the attached pages are expressed in terms of second quarter prices. For shipments exported in the third calendar quarter, these prices should be adjusted to reflect third quarter price changes published simultaneously today.

All the trigger prices being announced here will be used by the Customs Service to collect information at the time of entry summary on shipments of the products covered which are exported after the date of publication of this notice. However, the following rules will be applied to entries of these products covered by contracts with fixed price terms concluded before the publication date of this notice.

1. Contracts with fixed price terms between unrelated parties: If the importer documents at or before the time of entry summary that the shipment is being imported under such a contract with an unrelated party, the entry will not trigger an investigation even if the sales price is below the trigger price, provided that product is exported on or before June 30, 1979. However, failure to initiate an investigation will not diminish the right of affected interested persons to file a complaint with respect to such imports under the established procedures for antidumping cases.

2. Contracts between related parties: If the importer documents at the time of entry summary that the shipment is to be resold to an unrelated purchaser in the United States under a contract with fixed price terms concluded before the publication date of this notice, the entry will not trigger an investigation even if the sales price is below the trigger price, provided that product is exported on or before June 30, 1979.

While these sales will not as a rule trigger a self-initiated antidumping investigation, information concerning such sales will be kept as a part of the information in the monitoring system and will be available in the event that an antidumping petition is filed with respect to such products sold by that producer or the Treasury Department decided to self-initiate an antidumping investigation of such products based upon subsequent sales.

Robert H. Mundheim
General Counsel

Dated: MAY 15 1979

Attachment I

TABLE OF PRODUCT ADDITIONS AND ADJUSTMENTS

AISI Category/T.P. Handbook Page Number	and Product Description	Type of Action	Description of Action
2-6	Wire Rods, Cold Heading Quality	Extended Coverage	Added grade 1108
2-8	Wire Rod, Cold Finished Bar Quality	Extended Coverage	Added grade 1115, 1118
5-10	Plate	Correction	Corrected Pickled and Oiled Extra
14-9	ERW Pipe, Excluding Oil Well Casing Without Coupling	Correction	Corrected Grade and size extra
14-26, 14-27, 14-28, 14-29	Piling Pipe	Extended Coverage	Added large pipe sizes, for ERW and SAW Piling Pipe
14-33	ERW Mechanical Tubing ASTM-A 513	Correction	Corrected size extras
15-44	Seamless Carbon Steel Oil Well Tubing EUE with Threading and Coupling	Correction	Corrected size and grade extra
16-2	Cold Heading Round Wire	Extended Coverage	Added grade extras
19-1	Field Fence ASTM-A-116	Correction	Added note on insurance
21-1, 21-2	Barbed Wire	Extended Coverage	Added coating and size extras
16-32	Stainless Steel Wire	Extended Coverage	Clarified packaging extras

WIRE RODS - COLD HEADING QUALITY

Extra (Sizes/Grade) Per Metric Ton

GRADE (AISI NUMBER)	SIZES 7/32" thru 35/64	over 35/64" to under 39/64"	39/64" to under 3/4"	3/4" and over
1005, 1006, 1008 1010, 1011, 1012 1013 (Rimmed Steel)	Minus $26	$35	$19	NIL
1015, 1016, 1017 1018, 1019, 1020 1021, 1022, 1023, 1025, 1026 (Rimmed Steel)	Minus $26	$47	$34	$ 9
1005, 1006, 1008 1010, 1011, 1012, 1013 (Killed Steel)	Minus $ 8	$48	$34	$10
1015, 1016, 1017 1018, 1019, 1020 1021, 1022, 1023 1025, 1026	Minus $ 7	$62	$47	$24
1029, 1030, 1035 1037, 1038, 1039 1040, 1042, 1043	NIL	$48	$35	$10
10B18 10B21	22	86	72	46
10B22 10B23	27	91	77	50
10B30	24	73	57	35
1108, 1110	Minus 6	48	34	10
1522	NIL	66	52	27
1524	13	77	62	37
1541	10	59	45	21
15B41	36	84	70	45

Tolerance Extra

If bar tolerances are specified or required for over 35/64" to under 3/4" ... Plus $12/M.T.

WIRE RODS-COLD FINISHED BAR QUALITY

Extras (Sizes / Grade) Per Metric Ton

GRADE (AISI NUMBER)	SIZES 7/32" Thru 35/64"	Over 35/64" to Under 39/64"	39/64" To Under 3/4"	3/4" and Over
1015, 1016, 1017 1018, 1019, 1020, 1021, 1022, 1023 1025, 1026	Minus $40	$25	$10	Minus $12
1029,1030,1035 1037, 1038, 1039 1040, 1042, 1043 1044, 1045, 1046, 1049 1050	Minus $21	$26	$10	Minus $10
1117, 1115, 1118	Minus $ 6	57	43	19
1141	2	43	28	18
1144	2	48	34	10
1151	4	50	36	13
1212, 1213, 1215	Minus $ 2	48	34	10
10L18	Minus $18	58	44	20
10L38, 10L45	NIL	48	34	10
11L17	$25	91	77	50
11L37	17	64	49	26
12L14, 12L15	17	67	53	28

Tolerance Extra

If Bar Tolerances are specified or required for over 35/64" to under 3/4" -- plus $12 per metric ton.

3 - OTHER EXTRAS

Description		$/MT
Killed		24
Fine Grain		7
Charpy		
+40°F & up		
L		18
T		24
L & T		29
under +40°F		
L		24
T		29
L & T		36
Normalize		83
Quench & Temper		142
Normalize & Temper		142
U.S.T.		
A578 L2,	(over 1/2")	47
A435, A578 L1 (9" or higher grid)	(over 3/4")	18
(under 9" grid or 100% scanning)	(over 3/4")	29
Checker		24
Pickled & Oiled		
Up to 0.172" Thickness		24
Over 0.172" Thickness		16
Others		To be specified on SSSI

BASE PRICES INCLUDING OD/WT AND GRADE EXTRAS ($/M.T.)

ELECTRIC RESISTANCE WELD PIPE, EXCLUDING OIL WELL CASING, WITHOUT COUPLING

		A53 & API 5L	API 5LX Grades				
O.D.	W̄.T.	GRADES A & B	X42	X46	X52	X56	X60
2-3/8	.154	412	424	435	449	460	473
	.218	423	434	448	460	472	486
2-7/8	.203	401	412	424	436	449	460
	.276	422	424	435	449	460	473
3½	.216	389	402	413	425	436	449
	.300	401	412	424	436	449	460
4	.226	389	402	413	425	436	449
	.318	401	412	424	436	449	460
4½	.125	394	412	425	436	449	460
	.141	389	402	413	425	436	449
	.156	389	402	413	425	436	449
	.172	389	402	413	425	436	449
	.188	389	402	413	425	436	449
	.203	389	402	413	425	436	449
	.219	389	402	413	425	436	449
	.237	389	402	413	425	436	449
	.337	401	412	424	414	449	460
5-9/16	.156	385	395	407	419	430	442
	.188	385	395	407	419	430	442
	.219	385	395	407	419	430	442
	.258	385	395	407	419	430	442
	.375	395	407	419	431	443	454
6-5/8	.125	396	407	419	431	443	454
	.141	395	407	419	431	443	454
	.156	385	395	407	419	430	442
	.172	385	395	407	419	430	442
	.188	385	395	407	419	430	442
	.203	385	395	407	419	430	442
	.219	385	395	407	419	430	442
	.250	385	395	407	419	430	442
	.280	385	395	407	419	430	442
	.375	385	395	407	419	430	442
	.432	395	407	419	431	443	454

Piling Pipe ASTM A-252, ERW and SAW

AISI Category 14

Tariff Schedule Number 610.32 0.3¢ per lb.

	1st and 2nd Quarter
Base Price Per Metric Ton	$347

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	See Freight Table p. 14-1	$9	$6
Gulf Coast		5	8
Atlantic Coast		4	9
Great Lakes		4	11

Insurance: 1% of base price + extras + ocean freight.

Extras:

Outside diameter/wall thickness by grade.

Rev. May 1979

Base Prices Including OD/WT and Grade Extras ($/M.T.)

Piling Pipe ASTM - A-252

OD	W.T.	Grades 1, 2	Grade 3
6-5/8	.125	373	395
	.141	373	395
	.156	362	384
	.172	362	384
	.188	362	384
	.203	362	384
	.219	362	384
	.250	362	384
	.280	362	384
	.375	362	384
	.432	373	395
8-5/8	.125	357	378
	.156	357	378
	.172	357	378
	.188	347	367
	.203	347	367
	.219	347	367
	.258	347	367
	.277	347	367
	.312	347	367
	.322	347	367
	.344	347	367
	.375	347	367
	.500	357	378
10-3/4	.156	357	378
	.172	357	378
	.188	357	378
	.203	347	378
	.219	347	367
	.250	347	367
	.279	347	367
	.307	347	367
	.344	347	367
	.365	347	367
	.500	357	378
12-3/4	.172	357	378
	.188	357	378
	.203	347	367
	.219	347	367
	.250	347	367
	.281	347	367
	.312	347	367
	.330	347	367
	.344	347	367
	.375	347	367
	.406	347	367
	.500	357	378

Base Prices Including OD/WT and Grade Extra (S/M.T.)

Piling Pipe ASTM A-252 - ERW

OD	W.T.	Grades 1, 2	Grade 3
14	.188	357	378
	.203	357	378
	.219	347	367
	.250	347	367
	.281	347	367
	.312	347	367
	.344	347	367
	.375	347	367
	.438	347	367
	.500	357	378
16	.188	357	378
	.203	357	378
	.219	347	367
	.250	347	367
	.281	347	367
	.312	347	367
	.344	347	367
	.375	347	367
	.438	347	367
	.500	357	378
18	.219	357	357
	.250	347	347
	.281	347	347
	.312	347	347
	.344	347	347
	.375	347	347
	.438	347	347
	.500	357	357
20	.219	357	357
	.250	347	347
	.281	347	347
	.312	347	347
	.344	347	347
	.375	347	347
	.438	347	347
	.500	357	357

Base Prices Including OD/WT and Grade Extra ($/M.T.)

Piling Pipe ASTM - A - 252 - SAW

O.D.	16"	18" - 24"	26" - 48"
Grades 1, 2	461	448	435
Grade 3	487	474	461

ERW MECHANICAL TUBING ASTM-A-513 TYPE 1 AWHR
Base Price Including OD/WT Extras

	3/4	1	1-1/4	1-1/2	1-3/4	2	2-1/8	2-1/4	2-3/8	2-1/2	2-3/4	3	3-1/4	3-1/2	4	4-1/2
0.049	789	719	672	---	---	---	---	---	---	---	---	---	---	---	---	---
0.065	765	650	650	603	603	---	---	---	---	---	---	---	---	---	---	---
0.083	672	650	603	557	533	511	511	511	487	487	487	487	---	---	---	---
0.095	672	603	603	533	511	487	487	487	487	463	463	463	463	---	---	---
0.105	650	580	557	511	487	487	487	463	463	463	463	463	463	463	---	---
0.109	650	580	533	487	463	463	463	463	463	463	463	441	463	463	487	---
0.120	650	580	533	463	463	463	463	463	463	441	441	441	441	441	487	533
0.125	---	580	533	463	463	463	463	441	441	441	441	441	441	441	463	487
0.134	---	580	533	463	463	463	463	441	441	441	441	441	441	441	463	487
0.135	---	580	533	463	463	463	463	441	441	441	441	441	441	441	441	463
0.148	---	---	533	463	463	463	463	441	441	441	441	441	441	441	441	463
0.150	---	---	557	487	463	463	463	441	441	441	441	441	441	441	441	463
0.165	---	---	557	487	463	463	463	463	441	441	441	441	441	441	441	441
0.180	---	---	557	511	463	463	463	463	441	441	441	441	441	441	417	417
0.200	---	---	---	533	463	463	463	463	463	441	441	417	417	417	417	417
0.203	---	---	---	533	487	487	487	463	463	441	441	417	417	417	417	417
0.220	---	---	---	557	487	487	487	463	463	441	441	417	417	417	417	417
0.238	---	---	---	---	511	511	511	487	487	463	463	441	441	441	441	441
0.259	---	---	---	---	557	557	557	511	487	463	463	441	441	441	441	441
0.284	---	---	---	---	---	---	---	---	---	---	---	463	463	441	441	441
0.300	---	---	---	---	---	---	---	---	---	---	---	---	487	463	463	463

Intermediate wall thickness will be priced on the next heavier wall shown.

BASE PRICES INCLUDING OD, GRADE EXTRAS
($/MT)

SEAMLESS CARBON STEEL OIL WELL TUBING
EUE WITH THREADING AND COUPLING

AISI 15 TSUSA 610.49

Grade	H40 J55 K55	N80 C75 L80 L90 Others 80-85	P105 Others 90 and up
Outside Diameter (inches)			
2 3/8" and under	716	911	1101
2 7/8 - 4"	651	827	996

GRADE EXTRAS FOR COLD HEADING WIRE

Grade	$ Extra N.T. 1st and 2nd Quarter
AISI 1006 Killed through 1022 Killed Steel	Base
AISI 1010 Rimmed Steel	-15
AISI 1038 Killed Steel	+19
AISI 10B18 10B21 Killed Steel	+24
AISI 10B22, 10B23 Killed Steel	+24
AISI 10B30, 10B35 Killed Steel	+30
AISI 15B36, 15B41 Killed Steel	+40

FIELD FENCE A.S.T.M. A-116

Category AISI 19

Tariff Schedule Number 642.3570 0.1¢ per lb.

1st and 2nd Quarter

Base Price per Metric Ton

#11 Gauge Galvanized Wire $587

Charges to C.I.F.

	Ocean Freight	Handling	Interest
West Coast	$43	$9	$11
Gulf Coast	51	5	14
Atlantic Coast	56	4	14
Great Lakes	61	4	17

Insurance: 1% of base price + extras + ocean freight

Extras

Size Extra

$ Metric ton

Stay Wire Spacing

Filler Wire Size	6"	12"
#11	Base	Minus $3
#12-1/2	16	$13

BARBED WIRE 2 ply 12.50 GAUGE

Category AISI 21

Tariff Schedule Number 642.0200 Free

		1st and 2nd Quarter	
Base Price per Metric Ton		$618	
Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$43	$9	$9
Gulf Coast	51	5	12
Atlantic Coast	56	4	12
Great Lakes	61	4	14

Insurance 1% of base price + extras + ocean freight

Extras

1. Coating

2. Size Extras

BARBED WIRE

EXTRAS

1.	Coating Extra	\$/M.T.
	Regular Coating	Minus \$54
2.	Size Extra	\$/M.T.
	12 1/2	Base
	13	\$5
	13 1/2	\$10
	14	\$15

TOLERANCE EXTRAS

Standard: AISI or JIS Specification

Diameter Tolerance	$/MT
Standard	0
Not less than 1/2 standard	$116
Closer than 1/2 to 1/4 standard	25% of size extra
Closer than 1/4 standard	50% of size extra

Straightening and Cut to Length Extras

Size Range	Dollar per MT
.703" - .595"	104
.594" - .501"	104
.500"	104
.499" - .375"	131
.374" - .3125"	131
.3124" - .170"	236
.169" - .099"	590
.098" - .051"	1706
.050" - .032"	1968

Length	Dollar per MT
Under 12"	92
12" to under 18"	59
18" to under 24"	59
24" to under 30"	39
30" to under 36"	39
36" to under 48"	39
48" to under 60"	39
60" to under 72"	39
72" to under 120"	33
120" to under 168"	33
168" to under 192"	33
192" to under 216"	33
216" to under 240"	33
240" to under 264"	26
264" to under 288"	26
288" to 316"	26

Packaging Extras

Type	Dollar per MT
Bundle	29
Wooden Boxes	87
Fibre Drums	87
Coil Carriers	29
Spools	145
Both Spools and Wooden Boxes	
Sizes .020 and greater	87
Sizes under .020	232

AISI Category/T.P. Handbook Page Number and Product Description		Type of Action	Description of Action
25-4	Hot Rolled Sheet	Deletion	Deleted Theoretical Minimum weighing extra; Treasury will adjust the invoice price compared to the trigger price so that the invoice price reflects actual net weight, not the theoretical minimum weight. When sheet is sold based on TMW, the actual and the TMW weight should be shown for each line in column 16 of the SSSI.
26-6, 26-7	Cold Rolled Sheet	Correction and Deletion	Corrected width, length and thickness dimensions; deleted theoretical minimum weighing extra. See above, hot rolled sheet.
27-3	Electro-Galvanized Sheet	Deletion	Deleted theoretical minimum weighing extra; see above hot rolled sheet.
27-5, 27-7	Galvanized Sheet	Extended Coverage	Added Culvert Stock and Copper extra; deleted theoretical minimum weighing extra. See above, hot rolled sheet.

Other Extras	$/M.T.
1. Quality-Drawing Q-Rimmed	13
Killed	28
2. Structural-A570 D/E	18
3. Chemistry (Carbon Range)	
0.26% to 0.34%	28
0.35% & up	28+N
4. High Strength Carbon Steel	
YP 45,000 to 50,000 P.S.I.	13
YP 50,000 P.S.I. & up	13+N
5. High Strength Low Alloy Steel	
D-A607-G45	28
50	31
55	48
D-COR-TEN A	72

EXTRAS FOR COLD ROLLED STEEL SHEET

*WIDTH & THICKNESS

UNIT: US$/MT

Thickness, Inches	Width, Inches				
	$24 \le W < 36$	$36 \le W < 45$	$45 \le W \le 60$	$60 < W \le 68$	$68 < W \le 72$
$0.097 \le T < 0.126$	28	21	12	21	28
$0.083 \le T < 0.097$	28	21	9	19	28
$0.064 \le T < 0.083$	24	21	4	15	24
$0.054 \le T < 0.064$	24	17	0	9	24
$0.028 \le T < 0.054$	26	17	0	17	30
$0.023 \le T < 0.028$	43	34	19	24	38
$0.019 \le T < 0.023$	61	56	46	52	56
$014 \le T < 0.019$	82	77	67	70	

*CUT LENGTH

Thickness, Inches	Width, Inches	Length, Inches			
		$24 < L \le 42$	$42 < L \le 60$	$60 < L \le 144$	$144 < L$
$0.064 \le T$	$24 \le W \le 72$	26	25	22	25
$0.028 < T < 0.064$	$24 < W < 72$	24	22	20	22
$T < 0.028$	$24 \le W \le 72$	27	26	24	26

*COIL WEIGHT

GROSS MAX 10,000 lbs & OVER....................................NONE
GROSS MAX 10,000 lbs UNDER....................................... 2

*FINISH

DULL...NONE

COMMERCIAL BRIGHT..17

EMBOSSED NON GEOMETRIC...42

GEOMETRIC..53

*SURFACE TREATMENT

GREASED EDGES.. 1

SPECIAL CLEANLINESS REQUIREMENT

Thickness, Inches	Width, Inches	
	W≤36	36<W
0.021≤T	9	9
T<0.020	-	9

*QUALITY

COMMERCIAL..NONE

DRAWING..12

DEEP DRAWING 30

FULL HARD (ROCKWELL HARDNESS B-84 MIN)..............NONE

1/4 HARD..15

1/2 HARD..15

STRUCTURAL (PHYSICAL) - CARBON STEEL................18

TWO PRIME SIDES..18

CLASS II

....................MINUS..11

*CHEMISTRY

COPPER BEARING..12

RESTRICTED CHEMISTRY..........................N

*QUANTITY EXTRA

10 S/T≤Q<10 S/T.. 8

*RESTRICTED TOLERANCE..N

*OTHERS..N

(2) LENGTH

60" ≦ L ≦ 168"	18	
L < 60"	20	

(3) COATING

0.06 OZ/FT^2 on each side		+5
0.03	"	BASE
0.01	"	-2

(4) CHEMICAL TREATMENT

Phosphated	Base
Chromated	-2
Oiled	-2

(5) QUALITY

Commercial	BASE
Drawing	Subject to Negotiation
Drawing, Special Killed	"
Physical (TS, YP, HRS, etc.)	14

(6) PACKING

Coil	4ST UNDER	Subject to Negotiation
Sheet	3ST UNDER	"

(7) OTHERS Subject to Negotiation

EXTRAS FOR GALVANIZED STEEL SHEET

1. PRICE BASE

   QUALITY: COMMERCIAL

   SIZE : GSG23 (UNDER .032" THROUGH .029") x OVER 42" THROUGH 48" xCOIL

   COATING: G90

   WEIGHING: ACTUAL

2. EXTRAS FOR OTHER THAN PRICE BASE PRODUCTS (UNIT: US$ PER M/T)

   (1) THICKNESS/WIDTH/COATING

THICKNESS (INCHES)	WIDTH (INCHES)					COATING	
	24≦W<30	30≦W<36	36≦W≦42	42<W≦48	48<W≦60	0.6 oz/Ft²	G60
.130 & thicker	-81	-81	-81	-81	-	-	-2
.129 - .116	-66	-66	-66	-66	-64	-	-2
.115 - .101	-63	-63	-63	-63	-61	-	-2
.100 - .086	-58	-58	-62	-62	-58	-	-2
.085 - .075	-45	-45	-47	-47	-45	-	-3
.074 - .067	-42	-42	-45	-45	-42	-	-3
.066 - .061	-40	-40	-42	-42	-40	-	-5
.060 - .055	-29	-29	-31	-31	-29	-	-5
.054 - .049	-26	-26	-28	-28	-26	-13	-6
.048 - .043	-22	-22	-24	-24	-22	-15	-6
.042 - .038	-17	-17	-19	-19	-17	-18	-7
.037 - .035	-5	-5	-7	-7	-3	-18	-7
.034 - .032	-1	-1	-3	-3	0	-19	-8
UNDER .032 through .029	2	2	0	BASE	5	-19	-8
.028 - .026	5	5	3	3	11	-22	-11
.025 - .023	19	19	18	22	30	-22	-11
.022 - .021	26	26	26	30	40	-23	-15
.020 - .019	39	39	39	49	-	-23	-15
.018 - .017	47	47	47	64	-	-24	-17
.016	61	61	71	83	-	-24	-17
.015	72	72	87	97	-	-26	-19
.014	88	84	89	102	-	-26	-19
.013	101	95	95	107	-	-26	-19

WIDTH UNDER 24"-----------SUBJECT TO NEGOTIATION

Culvert Stock

Thickness (Inches) (INCHES)	
0.159 and thicker	$14
0.158 - 0.129	15
0.128 - 0.101	19
0.100 - 0.072	25
0.071 - 0.057	30
0.056 - 0.046	38

(5) QUALITY

COMMERCIAL	BASE
LOCK FORMING	NONE
DRAWING	13
DRAWING SPECIAL KILLED	31
STRUCTURAL	
GRADE A	3
" B and C	6
" D and E	13

(6) QUANTITY

$20ST \leq W$	BASE
$15ST \leq W < 20ST$	1
$10ST \leq W < 15ST$	3

(7) OTHERS-----------SUBJECT TO NEGOTIATION

(8) CORRUGATING $22

(9) COPPER EXTRA.....$8

Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
May 15, 1979

CONTACT: Charles Arnold
202-566-2041

TREASURY ANNOUNCES RESULTS OF GOLD SALE

The Department of the Treasury today announced that 750,000 troy ounces of fine gold were sold to 6 successful bidders at an average price of $254.92 per ounce.

Awards were made in 300 ounce bars whose fine gold content is 89.9 to 91.7 percent at prices ranging from $254.62 to $255.47 per ounce. Bids for this gold were submitted by 18 bidders for a total amount of 2.4 million ounces at prices ranging from $249.12 to $255.47 per ounce.

Gross proceeds from the sale were $191.2 million. Of the proceeds, $31.7 million will be used to retire Gold Certificates held by Federal Reserve Banks. The remaining $159.5 million will be deposited into the Treasury as a miscellaneous receipt.

The list of the successful bidders and the amount awarded to each is attached. The General Services Administration will release information on the individual bids made by all bidders, and the details of the individual awards to successful bidders.

The current sale was the thirteenth in a series of monthly sales being conducted by the General Services Administration on behalf of the Department of the Treasury. The next sale will be held on June 19 at which 750,000 ounces of gold will be offered in bars whose fine gold content is 89.9 to 91.7 percent. The minimum bid for these bars will be 300 fine troy ounces.

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		OUNCES
BANK LEU LTD. NEW YORK	 NY	1800
CREDIT SUISSE ZURICH	 SWITZERLAND	2400
DEGUSSA FRANKFURT	 GERMANY	3300
DRESDNER BANK AG NEW YORK	 NY	652,500
REPUBLIC NATIONAL BANK OF NY NEW YORK	 NY	30000
SWISS BANK CORP. ZURICH	 SWITZERLAND	60000

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

FOR IMMEDIATE RELEASE
May 16, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY ANNOUNCES WITHHOLDING OF APPRAISEMENT ON MARINE RADAR SYSTEMS FROM THE UNITED KINGDOM

The Treasury Department today said it has determined that marine radar systems from the United Kingdom are 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 Commission's decision 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.)

Appraisement in this case will be withheld for six months beginning May 17, 1979. The weighted-average margins of sales at less than fair value in this case were 2.72 percent.

Interested persons are being offered the opportunity to comment on this action.

Imports of marine radar systems from the United Kingdom during 1978 were valued at about $3 million.

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.)

Notice of this determination will appear in the Federal Register of May 17, 1979.

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

File Copy

For Release Upon Delivery
Expected at 2:00 p.m.

STATEMENT OF
THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON ENERGY AND POWER OF THE
HOUSE INTERSTATE AND FOREIGN COMMERCE COMMITTEE
May 17, 1979

Mr. Chairman and members of this distinguished Subcommittee:

Today I come before you to discuss our nation's energy crisis -- particularly as it relates to crude oil.

Nature of Our Energy Problem

This nation faces energy problems that strike to the core of our political and economic security, and affect the very stability of our society. The central problem is the availability and cost of crude oil. The story can be told by a few numbers. In 1970, the posted price of light Saudi Arabian crude, the key indicator of world oil prices, was $1.60 per barrel. Today the posted price is $14.54 per barrel, a nominal increase of 708 percent. In 1970, the U.S. met 76.7 percent of its crude oil needs out of its own production. Today, we meet only 50 percent of our needs from our own production despite gains from Alaska. In 1970, 72.7 percent of our oil imports were supplied by Western Hemisphere nations (primarily Canada and Venezuela). Today, less than 20 percent of our imports come from these countries. In 1970, our oil import bill was $2.9 billion. We now expect our 1979 oil import bill to be about $52 billion.

In 1958, 1975, and 1979, senior economic policy officials carefully examined, under Section 232 of the Trade Expansion Act and its predecessor, whether our national security is threatened by the volume and character of our oil imports. In each case the answer has been: Yes!

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The national security elements are clear:

- Because so much of the oil used in the United States originates thousands of miles away, supplies are vulnerable to interruption for a variety of causes. As the oil embargo of 1973 and subsequent energy shortages have illustrated, interruptions in energy supplies seriously disrupt our economy.

- As our oil import bills have skyrocketed, our export growth has not been sufficient to balance our trade accounts. Large trade deficits have been the result, with the consequent risk of dollar depreciation. Excessive dollar depreciation can be extremely harmful to the American people because it increases domestic inflation and erodes personal income. Excessive dollar depreciation also hurts the entire world economy because the dollar is the dominant currency in world trade and finance.

- If we continue to rely more and more on uncertain foreign sources of oil, the independence and vigor of our foreign policy is put at risk.

- Cartel control of over 50 percent of the world's oil supply exacts an increasing drain on the real resources of the consuming nations. It jeopardizes their economic security and ability to plan their economic futures. With world prices dictated by political forces, rather than by free markets, sensible inflation control becomes extremely difficult for the consuming nations.

- Our increasing oil imports play directly into the hands of the world oil cartel and add to upward pressures on world oil prices. Our oil imports today constitute 17 percent of world oil production. Absent increases in non-OPEC energy supplies, or a reduction in world oil consumption, rising U.S. oil imports will directly tighten the world market and undercut efforts to encourage responsible and moderate oil policies by the OPEC nations.

- Finally, as escalating U.S. oil imports suggest, this country is not yet making a determined and creative transition to a world in which oil supplies are scarce, expensive, and often unreliable. We are continuing to use energy, and particularly oil, at a far too lavish rate, and we are failing to make those long-term investments in alternate energy technologies that will be essential to our economic and political security in the remaining years of this century.

These are enormous problems. President Carter, to his everlasting credit, has chosen to address them. Last year, with the National Energy Act, we took major strides to correct imperfections in our coal, natural gas, conservation, and utility rate policies. But the core issue -- crude oil policy -- was not resolved at that time. By failing to act in this area, we left in place a system of price controls and entitlements imposed on domestic oil productio which aggravates our energy problems.

The system originated with the comprehensive wage and price controls instituted by the Nixon Administration in 1971 and has operated in its present form since 1973. The system has grown steadily more complicated and, at the same time, has intensified our energy problems. It does so by disguising from the American people -- consumers, investors, and industry alike -- what we are all really paying for oil. Because of it, we use and import more oil than we should; we produce less domestic oil than we should; and we neglect to make economically sensible and necessary investments in alternative energy sources and technologies.

The oil pricing system sets various ceiling prices for the domestic production of oil. Lower-tier oil -- production from fields in operation in 1973 -- is generally capped at about $6 per barrel. Upper-tier oil -- production from fields placed in operation since 1973 -- is capped at approximately $13 per barrel. The system also requires refiners to make payments --known as "entitlements" -- to each other so that each refiner pays the same average price for a barrel of oil, regardless of the source of supply.

The results of these controls and regulations are rather obvious:

° The average price of oil to refiners, and thus to individual and industrial consumers of oil, is substantially less than the world price. For example, in February of this year, the country was facing a price of $15.80 a barrel for imported oil on the world market. But the controls-and-entitlements system established an average refiner price of $13.24 per barrel, regardless of source. As a consequence there was an effective, federally-mandated subsidy of $2.56

per barrel to import oil, rather than use domestic oil, and a like subsidy to consume oil, rather than to conserve it or use some alternative form of energy, such as coal, natural gas, or solar energy.

- The incentive to produce oil domestically is artificially depressed. About 40 percent of domestic oil has been subject to the lower-tier cap of about $6 per barrel, and another 30 percent to the upper-tier cap of about $13 per barrel. Compared to a world price of $15.80 per barrel in February, these controls constituted a straightforward signal to oil owners to invest in more profitable ventures, either here or abroad.

In brief, since the OPEC-generated explosion of oil prices in 1973, the U.S. has been operating a program that encourages oil consumption and imports and discourages domestic oil production and the development of new energy sources. Although this has been done in the name of "protecting" the consumer, it has had precisely the opposite effect. By discouraging investments in domestic oil production and development of alternative energy sources, by enlarging the trade deficit and weakening the dollar, and by tightening world oil markets, these price control policies have added to upward price pressure not only on world oil prices but also on the general price level of all goods and services. Far from protecting the consumer, the domestic oil control system has instead served to aggravate inflation.

<u>The President's Program</u>

The President has recently addressed the critical problems created by our dependence on oil imports in the following ways.

- <u>By agreeing with our allies in the International Energy Agency to reduce U.S. imports (by the fourth quarter of 1979) by up to 1 million barrels a day below levels expected prior to the 1979 OPEC price increases</u>. This action --and similar actions by our allies -- should moderate future increases in world oil prices, reduce our trade deficit and strengthen the dollar.

- <u>By phasing out price controls on domestic crude oil</u>. This ends the subsidy to consumers of oil, encourages conservation and substitution of other energy sources, and provides appropriate incentives to expand domestic oil production.

- By proposing a windfall profits tax. This captures for the U.S. Treasury some of the excessive profits from existing oil wells and a portion of future windfalls generated by OPEC price increases, and creates a mechanism through which the U.S. can offset the effects of decontrol on the poor, encourage energy efficient mass transit and further its efforts at developing alternative energy sources.

The Decontrol Program

The key element in the President's program is the decontrol of crude oil prices. The route chosen will delay as much of the inflationary impact of decontrol until 1981 or 1982 as is practicable while maximizing the incentive to increase production in 1979 and 1980.

The major features of the decontrol program adopted by the President are:

- Producers of lower-tier oil (also called "old" oil) will be allowed to reduce the volume of output they are required to sell as old oil by 1-1/2 percent each month in 1979 and 3 percent each month from January, 1980 to September, 1981, determined from new control levels established as of January, 1979. This means that a property whose old oil control level is 100 barrels a day in January, 1979 will be required to sell as old oil only 82 barrels a day in December, 1979, and 46 barrels a day in December, 1980. Production above these levels may be sold as upper-tier oil.

- The price of upper-tier oil will be phased up to the world price beginning on January 1, 1980 and ending on October 1, 1981.

- As of June 1, 1979, newly discovered oil will be decontrolled, as will that volume of production from any oil field that results from introducing tertiary recovery programs.

- Production from marginal wells -- that is, wells producing less than specified amounts of oil in 1978 -- will be allowed to sell at the upper-tier price beginning June 1, 1979.

A key aspect of this program is the decontrol of old oil. From 1976 to 1978, oil price regulations gave the lowest return to those producers who made the greatest effort to increase production after the 1973 embargo, while giving the highest return to those producers who did the least to meet the national need after 1973. The decline rate change for lower-tier oil announced by the President eliminates the disincentive to produce from old oil fields, since the profit earned from increased production in old oil properties will be the same as from investments in new oil properties. From the standpoint of production incentives, a rapid decline rate is the most efficient method of decontrolling lower-tier oil.

A second critical element in the President's program is the decontrol of newly discovered oil and incremental production which results from the completion of tertiary recovery projects. No longer will exploration for new reserves in untapped areas be discouraged by a stifling system of price controls. Further, the incentive to invest in tertiary projects which involve risky efforts to apply expensive, experimental procedures to the recovery of additional oil from depleted reserves will be as great as the incentive to explore for newly discovered oil. This is as it should be in a competitive economy.

The Windfall Profits Tax

Decontrol is an essential step toward a sensible national energy policy. However, decontrol will create some windfall profits since, in many instances, the world price exceeds that necessary to induce rapid production and discovery. To recapture some of these windfall profits, while at the same time preserving production incentives, we have proposed a tax of 50 percent on the windfall profits per barrel generated by decontrol and by future OPEC price increases. An additional portion of the windfalls will automatically be recovered through existing federal income tax laws.

Our tax involves a 50 percent levy on three bases: the windfall profits from moving lower-tier oil to the upper tier; the windfall profits from moving upper-tier oil to the world price; and the windfall profits from future real increases in the world price.

A. Lower-tier

The tax on old oil would be equal to 50 percent of the difference between the price at which the oil is sold and the control price of the old oil. The control price is currently about $6.00 per barrel and is to be increased by inflation.

The Administration's tax on old oil is imposed on production which most likely would have come forth had controls remained in effect, so that genuine increases in production from old oil properties are not taxed. Specifically, the tax applies only to that volume of lower-tier oil freed to the upper tier under decontrol which exceeds the volume of oil which would be freed under a 2 percent decline rate after January 1, 1980.

The decontrol plan uses a 3 percent decline rate while the windfall profit tax uses a 2 percent rate. The difference is dictated by economics. As I noted above, a 3 percent decontrol decline rate was required to provide the incentive of replacement cost pricing for old oil properties and also to allow for a smooth transition to complete decontrol in 1981. Had a lower decline rate been employed, the "gap" when complete decontrol is required in 1981 would have been larger and the inflationary shock in 1982 greater.

However, the 3 percent decline rate exceeds the actual decline rate observed in almost every oil field. Thus, a 2 percent decline rate was selected for tax purposes as being closer to historical experience. Using a lower decline rate than 2 percent for tax purposes would obviously increase the amount of old oil subject to tax, but would risk discouraging production to some extent. The 2 percent decline for tax purposes represents a reasonable balance between capturing windfalls and assuring maximum production.

B. Upper-Tier

The tax on upper-tier oil will be equal to 50 percent of the difference between the price the oil sells for and the inflation adjusted price of upper-tier oil. The tax would begin phasing out in November, 1986, and would disappear by January, 1990. The upper-tier tax will have little if any adverse impact on production of upper-tier oil since the control price was close to the world price before the recent OPEC surcharges.

The upper-tier tax is phased out in order to simplify the windfall profits tax at a point in time when fine distinctions are no longer needed. Computing the upper-tier tax requires reference to the last vestiges of price controls. Since revenue from the upper-tier tax will decrease substantially after 1985 as the volume of upper-tier oil diminishes, we decided to phase out the upper-tier tax after 1986.

The upper-tier tax excludes new production, incremental tertiary production and any oil subject to the lower-tier tax.

C. Uncontrolled tier

The upper- and lower-tier tax bases will cover about two-thirds of U.S. production. The remaining third is composed of output from the Alaskan North Slope, stripper wells (wells that produce less than 10 barrels a day for a 12-month period), newly discovered oil and incremental production resulting from the introduction of tertiary recovery procedures in old oil fields. These categories of production are now either decontrolled or effectively decontrolled, and thus are able to earn the world market price.

The third base of the windfall profits tax applies to this uncontrolled oil (other than Alaskan North Slope oil) to the extent not subject to the lower-tier or upper-tier tax. The 50-percent tax would be imposed on the difference between what the producer receives, and a base price of $16 per barrel as of January 1, 1980. The base would be adjusted for domestic inflation occurring after 1979. Eventually, the decontrolled tier tax would apply to all other domestic oil, as it is decontrolled.

A number of questions have been raised concerning the $16 per barrel base price for the uncontrolled tier tax. The $16 figure is based on the estimated world price which would be in effect as of the first quarter of 1980 as a result of the December, 1978 OPEC price announcement. The base price was calculated to allow for uncertainties about the difference between the posted price of Saudi Arabian marker crude, and transportation costs, quality differentials and other relevant factors. By choosing $16, most domestically produced uncontrolled crude oil would pay no tax unless OPEC were to raise its prices in excess of inflation.

Second, it has been suggested that the $16 base be increased because recent OPEC surcharges have already increased the price of oil. However, the President's windfall profits tax proposal is designed to prevent domestic producers from benefiting from just these kinds of sudden price increases. There is no rational reason for exempting the profits domestic producers are realizing from these surcharges from the windfall profits tax.

Third, it has been argued that since the tax on the uncontrolled oil tier is permanent, the United States is permanently condemning producers to a lower price at home than they might realize abroad, and that the United States will produce less oil than would be produced in the absence of a permanent tax.

It is simply not true that producers can earn even more abroad than they can at home if the uncontrolled tier tax is enacted. In every other producing country, increases in the price of oil have immediately been accompanied by increases in taxes on producers or by nationalization. Either action deprives the producer of the increased revenues.

Moreover, those who argue that we will lose a small amount of domestic production due to the uncontrolled tier tax fail to recognize the risk of imposing no tax at all. Political forces will not allow complete and permanent decontrol of oil so long as we face an unqualified threat of embargoes and sudden price increases. In the absence of a permanent tax, a future surge in oil prices may compel a return to regulation. It is preferable to risk sacrificing the very small potential supply response in order to avoid such a situation. By imposing a permanent tax with a base which is adjusted for inflation, I believe we will, in the long run, allow producers to receive approximately the same price as is received outside the U.S. but with standby protection that will prevent them from receiving sudden windfall profits due to increases in prices as a result of anti-competitive cartel practices.

D. Further comments

I would like to respond to some of the general questions that have been raised about the President's windfall profits tax proposal.

It has been suggested, and I believe misleadingly so, that the Administration has proposed a "weak" tax. This is not so. Our goal is to capture windfalls without prejudicing production incentives. This we have done.

There are almost no exceptions to the upper-tier tax. The only exception to the uncontrolled-tier tax is the well-justified exclusion for Alaskan North Slope oil. The exceptions to the lower-tier tax are geared to ensure maximum possible production from domestic sources, and old oil exempt from the lower-tier tax is subject to the upper-tier tax. Furthermore, the uncontrolled tier tax is permanent, and captures half of all increases in oil industry revenues which are due to price increases beyond that which would be allowed solely by inflation.

Absent our windfall profits tax, producers would receive $0.43 net from each dollar increase in revenue. With the tax, the producer's take drops to $0.29 per dollar. Assuming oil prices do not increase in real terms beyond 1979, the tax reduces by 30 percent the amount of money which the oil industry would actually keep as a result of decontrol. If oil prices were to increase in real terms, say, by 3 percent per year, the tax would reduce industry revenues from decontrol by 40 to 45 percent.

Assertions that the tax is weak have in some instances been based on misleading comparisons. For example, comparisons are made between the gross revenues generated from decontrol -- before payment of any additional production costs and any taxes -- and the net federal tax receipts due to the windfall profits tax. These types of comparisons fail to take into account the automatic effect of other taxes and the increased expenditures for greater oil output. The proper comparison is between producer and royalty revenues with and without the windfall profits tax. Under this analysis, producer and royalty revenues are 30 to 45 percent lower with the windfall profits tax than without it.

It has also been said that the windfall profits tax denies capital required for further exploration. Such arguments are without economic foundation. The economic incentive is provided by the price of newly discovered oil, not by the cash flow from existing production. The argument for increased cash flow is untenable. It would lead to a cheap source of capital for those now engaged in the exploration for oil and gas while new entrants must pay the market price for capital. This is inconsistent with a competitive economy, because it would further impede entry by non-oil firms into oil production and thus reduce competition. Moreover, providing "free" capital means that the investment basis in oil property is reduced. To be consistent, the "cash flow" advocates should demand that such oil be sold at a lower price -- or perhaps given away -- since the investment has already been recovered.

A variation on the "cash flow" argument is plowback. Plowback is an offset against the windfall profits tax for certain oil-related investments. Plowback should be recognized for what it is: a subterfuge for repealing the windfall profits tax. This tax is being sought in part because some of the increased profits from decontrol are windfalls that do not lead to appreciably increased domestic oil production. Likewise, plowback -- which is merely a reduction in the tax -- will not necessarily add to domestic oil production.

Proponents of plowback argue that it provides a useful subsidy for domestic oil production. However, as a subsidy, plowback is deficient. Since plowback would be limited only to present owners of oil, it would provide no incentive to new entrants into production. This would discourage competition in the industry and encourage concentration. Moreover, plowback subsidies would be distributed only to the owners of interests in the oil, such as royalty holders. Not all owners produce oil, and it is production, not mere ownership, which should be encouraged. In addition, plowback would require complex and arbitrary definitions of threshhold or base period investment levels and of qualifying investments, leading to interminable administrative disputes and litigation.

Finally, some have challenged the windfall profits tax proposal on the basis that we subject no other windfall to a special tax. This argument ignores the very special circumstances of the domestic oil industry. Windfalls are most commonly found among commodities, such as oil. In most cases, however, competition and the legal structure of the market rest within the authority of the United States. This is simply not the case with respect to oil prices. The windfalls are attributable to the action of a foreign cartel, totally outside the legal control of the United States. There is simply no sound reason why we must stand idly by and permit windfalls to be reaped in the United States because of actions taken by a foreign cartel.

Energy Security Trust Fund

The President has proposed to convert windfall profits derived from OPEC pricing into the direct advancement of energy technology, the development of energy efficient mass transit, and for assistance to those least able to afford energy price increases attributable to decontrol. This will be done through the Energy Security Trust Fund.

The Fund will consist of the proceeds of the windfall profits tax, and increased federal income taxes attributable to decontrol during the deregulation period. The Fund is an addition to, and not a replacement of, existing Department of Energy funding.

The cost of all Fund programs will be limited to Fund resources. The new programs will be undertaken only if the windfall profits tax is enacted. The cost of any new energy tax expenditures will be charged against Fund receipts in order to control these subsidies more effectively. All spending programs financed from the Fund will be subject to annual authorization and appropriation. Given available funds, additional initiatives may be undertaken to reduce U.S. oil import dependence.

The Treasury Department will be responsible for holding the Fund, and for estimates of revenues and tax expenditures. On the basis of these estimates, and estimates made by OMB of other demands on the Fund, the extent of Fund resources available will be determined.

Economic Impacts

We estimate that the additional inflation resulting from phased decontrol compared to retaining controls indefinitely amounts to about 0.1 percent in 1979 and averages 0.2 percent a year over the next three years. By 1982, the level of the consumer price index will be approximately 0.75 percent higher with phased decontrol than if controls had been retained indefinitely.

These estimates assume that OPEC prices rise only as fast as world inflation. If world oil prices increase faster than world inflation, the inflationary impact of decontrol would be slightly greater. For example, if world oil prices increase 3 percent a year faster than world inflation, the level of the consumer price index will be approximately 0.9 percent higher by 1982. Thus, the inflationary impact of decontrol is not very responsive to faster OPEC price increases. This is because price controls govern only a third of all U.S. oil consumption. The remaining two-thirds (imports, stripper production, and Alaskan oil) are already free to receive the world price.

These inflation estimates are based only on quantifiable decontrol effects, such as the higher prices of gasoline, heating oil, and goods manufactured from petroleum, and the induced impact on prices resulting from wage increases caused by cost of living adjustments made in response to the additional inflation. The estimates do not include any effects from reduced prices of non-energy imports due to the strengthening of the dollar, and from the lower oil prices which would result from future world oil price moderation due to reduced U.S. demand. The excluded effects are simply not quantifiable. Since the nonquantifiable elements suggest lower inflation impacts, it is probable that our numbers overstate the effect of decontrol on inflation.

Decontrol will restrain aggregate demand and economic growth slightly over the next two years -- by perhaps 0.1 percent a year. In later periods, fiscal and monetary policy can be adjusted to the needs of the economy as they develop, taking into account the specific economic impacts of decontrol and expenditures from the Energy Security Trust Fund.

The Department of Energy estimates that, relative to continued price controls, the President's program will reduce oil imports by about 370,000 barrels per day in 1981 and 950,000 barrels per day by 1985, assuming OPEC prices increase only with worldwide inflation. Should OPEC raise prices at a rate in excess of worldwide inflation, the oil import savings would be greater. DOE has estimated that imports would be reduced by 440,000 barrels per day in 1981 and 1,100,000 barrels per day in 1985 under a case where OPEC raised its prices at a rate which was 3 percent per year greater than worldwide inflation.

Conclusion

The U.S. faces a severe energy problem today despite recent corrective measures. At the root of our present energy problem is the price of oil. In the past we have refused to address this problem because of the windfall profits involved. We can no longer afford to avoid the issue. By artificially supressing the price of oil, too much oil is consumed and too little produced; other efforts to solve our energy problem are frustrated; and less incentive to switch to other fuels or to conserve energy is provided.

President Carter has recognized this dilemma. He has acted to decontrol crude oil prices permanently by the end of 1981. He has also addressed in an effective manner the issue of windfall profits created by decontrol.

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

For Release Upon Delivery
Expected At 2:00 p.m. E.D.T.

STATEMENT OF
JOHN M. SAMUELS
TAX LEGISLATIVE COUNSEL
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE OF HOUSING AND COMMUNITY DEVELOPMENT
OF THE
HOUSE COMMITTEE ON BANKING FINANCE AND URBAN AFFAIRS
Thursday, May 17, 1979

Mr. Chairman and members of the Subcommittee:

We welcome the opportunity to present the Treasury's views on guarantees of certain tax exempt hospital bonds by the Department of Housing and Urban Development.

HUD has recently decided not to allow GNMA mortgage-backed securities to be used as collateral for certain tax exempt bond issues. The HUD decision affected a new kind of financial arrangement under which tax-exempt bonds were backed by a GNMA guarantee. The guarantee was obtained indirectly, by pledging GNMA mortgage-backed certificates as collateral for tax-exempt revenue bonds. Because this device, generally known as "combination financing," raised serious questions of tax policy and debt management, the Treasury Department requested HUD to review its policy with respect to such arrangements. As a result of this review, HUD announced on March 29, 1979 that it would no longer

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approve GNMA guarantees in the case of combination financing arrangements proposed for hospitals and certain housing projects. The Treasury believes this decision was correct and fully supports it.

The double benefit of a Federal guarantee and an income tax exemption for these State and local bonds represented a fundamental departure from longstanding Federal policy. Combination financing effectively accorded certain tax-exempt State and local government bonds the extraordinary benefit of the backing of the full faith and credit of the United States.

Last year, the Congress rejected this double benefit -- both a tax exemption and a federal guarantee -- in the case of the New York City Financial Assistance Act. The Congress determined that it was inappropriate to provide New York City with this double benefit, even in connection with a program necessary to assure the City's financial survival. In the case of a typical combination financing, where much less than financial survival is at stake, this double benefit is still less appropriate.

Federally backed tax-exempt obligations create potentially serious problems of Federal debt management. The double benefit of an income tax exemption and a federal guarantee creates a security that is superior to the obligations of the United States itself. Proliferation of such issues could seriously interfere with the marketing of U. S. Government debt obligations, particularly if this financing technique were to be adopted in connection with other federal guarantee programs.

Combination financing also presents serious problems of tax policy. The revenue loss to the Treasury substantially exceeds the interest savings to hospitals and other municipal borrowers. On the average, each $1.00 of interest savings to the tax-exempt issuer will cost the Treasury $1.33. This inefficiency is perhaps best illustrated by an example. In recent months, the yield on high grade taxable securities has been about 10%, and the yield on tax exempt bonds of similar quality about 7%. This means that the tax-exempt issuer is paying 70¢ in interest rather than $1.00, and realizes a savings of 30¢ by borrowing in the tax exempt market. Currently, the average marginal tax bracket for holders of tax-exempt bonds is approximately 40 percent. The income tax exemption therefore costs the Federal government 40¢ in foregone tax revenues for each 30¢ saved by the issuer in debt service costs. Put another way, this means that the Federal Government spends $1.33 for each $1.00 in issuer savings.

Combination financing arrangements tend to be even more inefficient than tax-exempt financing in general. The stated public purpose of these collateralized bond issues is to reduce hospital debt service costs. However, in a number of these proposals, only a portion of the interest savings would actually be used for this purpose. Instead, a substantial fraction of the savings would be captured by the issuing authority, by existing mortgage holders, or both. Only a portion of the total savings would actually be passed on to the hospital itself. In these transactions, which may be designed primarily to secure an investment profit, the public value of the transaction is diminished and the inefficiency greatly increased.

We are particularly concerned about refinancings of outstanding GNMA certificates. For example, assume that a hospital sold a GNMA certificate several years ago. Because of market conditions when it was sold, the certificate bears interest at a rate of 9%. However, the certificate would trade on the secondary market today at a discount, producing a yield of 10%. In the refinancing transaction, a public authority sells tax exempt bonds at a yield of 7%. The bond proceeds are then used to purchase the GNMA certificate which, as noted above, has a market yield of 10%. Thus, the transaction produces an investment profit of 3% each year (i.e., the difference between the 7% interest rate on the tax exempt bonds and the 10% market yield on the GNMA certificate). This investment profit might be divided between the hospital, the public authority, and the original holder of the GNMA certificate.

To continue the example, the holder of the certificate is paid the par value, even though the certificate would trade on the secondary market at a discount. In this way, the holder of the certificate receives 1 percentage point of the annual investment profit. In addition, the stated interest rate on the certificate is reduced to 8%. As a result, the hospital also receives 1 percentage point of the investment profit. Finally, the remaining 1% of the investment profit goes to the public authority. Thus, the investment profit is shared by the original holder of the certificate, the issuing authority, and the hospital. Because the hospital receives only a fraction of the investment profit, this kind of refinancing transaction is particularly wasteful.

Moreover, we have reservations about the tax exempt status of the bonds in this type of transaction. The Internal Revenue Service is presently studying the tax status of these bonds under existing statutes and regulations, and we expect that they will publish a ruling on this question within a few months.

An income tax exemption for interest paid on State and local government bonds also creates serious inequity within the Federal income tax system because of the benefit bestowed on taxpayers at the highest income levels. The bonds must carry a yield high enough to attract taxpayers in the 30 percent bracket. This high yield results in a windfall to higher bracket taxpayers.

When the supply of tax-exempt bonds increases, tax-exempt interest rates must also generally increase. Higher tax-exempt financing costs compound both the inefficiency and the inequity of tax-exempt financing. The savings of the issuer are diminished, and the average cost to the Federal Government per dollar of issuer savings is increased.

The volume of GNMA backed debt that could potentially be refinanced using the combination device is quite large. Hospitals are not the only institutions involved. GNMA guaranteed certificates are also backed by FHA insured multifamily housing mortgages. The amount of GNMA guaranteed hospital and multifamily housing indebtedness presently involved is approximately $2.35 billion. New issues of GNMA backed securities could substantially increase this amount. We believe that transactions of this magnitude could have a substantial adverse impact on Treasury revenues.

Federally guaranteed tax-exempt bonds also represent a serious threat to the tax-exempt market. They are superior to all other State and local government bonds because they are virtually risk-free. An influx of such bonds onto the market would tend to drive up municipal interest rates and to crowd out conventional tax-exempt bonds designed to finance roads, schools, municipal buildings, and other essential public projects.

Finally, some hospitals have argued that combination financing should be encouraged as a hospital cost containment measure. This argument is without merit. The primary purpose of hospital cost containment is to hold down the real costs of hospital care, not merely to disguise increases in hospital service charges by shifting some costs to the taxpayers of the country as a whole. Moreover, to the extent that combination financing appears to reduce hospital costs without really doing so, it could actually hamper the efforts of the Administration to achieve effective controls.

For the above reasons, we fully support HUD's decision to withhold GNMA guarantees from combination financing.

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

FOR RELEASE AT 4:00 P.M. May 16, 1979

TREASURY TO AUCTION $2,250 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $2,250 million of 2-year notes to refund $1,848 million of notes maturing May 31, 1979, and to raise $402 million new cash. The $1,848 million of maturing notes are those held by the public, including $700 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 $239 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

B-1610

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC OF 2-YEAR NOTES TO BE ISSUED MAY 31, 1979

May 16, 1979

Amount Offered:	
To the public	$2,250 million
Description of Security:	
Term and type of security	2-year notes
Series and CUSIP designation	Series T-1981 (CUSIP No. 912827 JR 4)
Maturity date	May 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 auction
Interest payment dates	November 30 and May 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	Tuesday, May 22, 1979, by 1:30 p.m., EDST
Settlement date (final payment due)	
a) cash or Federal funds	Thursday, May 31, 1979
b) check drawn on bank within FRB district where submitted	Tuesday, May 29, 1979
c) check drawn on bank outside FRB district where submitted	Friday, May 25, 1979
Delivery date for coupon securities.	Wednesday, June 6, 1979

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

FOR IMMEDIATE RELEASE
May 17, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY TO START ANTIDUMPING
INVESTIGATION OF PORTABLE
ELECTRIC TYPEWRITERS FROM JAPAN

The Treasury Department today said it will start an antidumping investigation of imports of portable electric typewriters from Japan.

Treasury's announcement followed summary investigations conducted by the U. S. Customs Service after receipt of a petition filed by SCM Corp. alleging that firms in Japan are dumping this merchandise in the United States.

The petition alleges that these imports 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 November 18, 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 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 May 18, 1979.

Imports of portable electric typewriters from Japan in 1978 were valued at $55.8 million.

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B-1611

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

FOR RELEASE ON DELIVERY
Expected at 1:00 P.M. EDT

REMARKS BY
THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
AT THE
NATIONAL COUNCIL FOR U.S.-CHINA TRADE
WASHINGTON, D.C.
MAY 17, 1979

Mr. Ambassador, President Phillips, distinguished members of the National Council for U.S.-China Trade:

It is a great pleasure to address this esteemed group on the occasion of its Sixth Annual Membership Meeting. I remember vividly the early discussions leading to the establishment of the Council in which I played an active part. You have come a long way since those days. And no year has been as momentous as this past one. For this past year has seen a sea-change in our economic relations with China.

On December 15 of last year the President made his historic announcement concerning normalization of diplomatic relations with the People's Republic. At the dawn of the new year Deng Xiaoping visited Washington and issued with President Carter a communique setting out, among other priorities, an intention to negotiate trade, shipping and aviation agreements and to get on with the business of bilateral commerce. In late February a Treasury delegation travelled to Beijing where we began to lay a foundation. We opened our Embassy and negotiated and initialled a claims/asset settlement. We initiated discussions on trade. And we established the U.S.-China Joint Economic Committee to oversee and coordinate the expansion of our bilateral economic relationship.

Now, in this past week, Secretary Kreps has signed the claims/assets accord and has initialled an MFN trade agreement. She has negotiated four science and technology agreements and an accord on trade exhibitions. And negotiations on textiles, maritime and civil aviation agreements are in the works.

B-1612

In less than six months we have gone from zero to full speed ahead in our bilateral economic relations with China.

We have substantially bridged the gap that has separated the U.S. and the PRC for two decades.

So, where does this leave us? Specifically, what are the prospects for American firms who wish to do business with and in China?

To answer that question requires that we assess:

a) the current domestic situation in China;

b) the status of the competition;

c) the political and economic wherewithal of the private and public sectors at home. Let me review these for you in turn.

The Situation in China

The speed with which the obstacles to a more normal bilateral economic relationship are being overcome pales when compared to the pace of change that has occurred domestically in China. In the past year the new Chinese leadership has attempted some remarkable transformations.

On the economic side, the Four Modernizations has become the national goal. The people have been exhorted to "act in accordance with economic laws"; to stress practical economic considerations. New party organizers and non-party intellectuals and technicians have been brought in to implement the new economic plan. And government bureaucrats, students and workers are being given a vested interest in economic progress.

The National People's Congress early last year approved a highly ambitious ten year plan. In agriculture, the plan calls for increased investment, increased incentives, and a decentralization of the decision making process. In industry, the intent is to modernize the nation's industrial plants through the acquisition of western machines and technology for production of petrochemicals, synthetic fibers, metals, transportation and communication. The Leadership has also relaxed constraints which had previously inhibited the application of foreign methods. Most striking amongst these relaxations has been the decision to consider a variety of investment schemes. When I was in Beijing, the Government made it clear that they were fully open to alternatives such as joint ventures, barter and product payback deals, long term credits, and government-to-government loans to finance modernization.

There has of late been some "readjustment" of these efforts. There has been debate on economic priorites: some of the more ambitious goals have been scaled down and there has been a partial reemphasis on agriculture and light industry. Still the Chinese tell us, and we believe them, that they are "firm and unshakable" in their drive to modernize. Indeed, the Foreign Trade Minister, Li Qiang, summarized the situation recently by saying that "the readjustment of our economy undertaken at the moment is exactly for the purpose of concentrating our efforts on the most needed projects and widening the pace for the Four Modernizations."

It is not really surprising that this kind of readjustment takes place. The Chinese stated frankly from the outset that their plans were ambitious and we, for our part, warned our business interests against unrealistic expectations. Still, in a manner akin to those who watch and read so much into the weekly changes in the money supply, the new China watchers have begun to read something fundamental into every new piece of evidence emanating from China, be it the sales figure for the Canton Fair or this or that poster on Democracy Wall. The point I suppose we all agree on is this: China is embarked on a rapid path of change. Adjustments and threats to endurance are inevitable. As with most such efforts, the potential return is great. But so equally is the risk.

Mr. Ambassador, I know you won't mind my saying that there are risks in any attempt of change. We know this well from our own attempts to change the inflation psychology of our own economy. No one can assess the risks entailed in so fundamental and unorthodox an attempt as that being made by Vice-Premier Deng and Chairman Hua. Investors must make up their own minds as to whether or not a process of development like this one, once underway, can be stopped; or whether a political effort of this basic nature, once embarked on, can ever be reversed; or whether the people will have the patience to stay the course and accept the strains and setbacks that are inevitable.

The domestic situation in China tells us that we must approach investing and doing business there with a sense of realism and proportion. Obviously, profitable business can be done in China and we are eager for it. But for some time to come business will have to be done under conditions of uncertainty. This is a fact.

The Competition

This does not mean that there is lack of room for an expansion of America's market share in China. Others have done quite well in the current trading environment and have strong expectations for the future. Let me describe briefly where we stand relative to the competition.

The U.S. ranks well behind Japan and Europe in trade with China. In 1978 China imported a little over $10 billion of goods from abroad; the U.S. supplied only eight percent of this total. In that year China exported goods totalling almost $10 billion, of which the U.S. imported three percent. Our total share of two way trade with China is a slim six percent. This compares with 25 percent for Japan and 18 percent for the European Community. We can and we must do better.

In seeking to expand our position, we must contend with the following competitive situation:

-- We must compete against Japan. In 1978, Japan captured, by value, half of the $7 billion worth of contracts signed by the Chinese. The Japanese and Chinese have signed a long-term trade agreement which has been extended through 1990 and aims to increase two-way trade to $40-60 billion. In addition, the Japanese government and private banks have been discussing a variety of long and short-term facilities to finance this trade. Just yesterday, for example, Japanese private banks signed a four-and-a-half year syndicated loan to China of $2 billion denominated in dollars. And they announced short-term loans totalling $6 billion.

-- We must compete with West Germany, who does not have a bilateral trade agreement, but already sells $1 billion in exports to China.

-- We face competition from France and the United Kingdom, who each recently entered into trade agreements with China which call for bilateral trade to approach the $14 billion mark by 1985. To finance purchases under the agreement, both France and the United Kingdom have officially backed $7 billion and $5 billion respectively in credit commitments.

-- And there are others. The European Community collectively signed a five year nonpreferential trade agreement with China in April of 1978. And Italy has been discussing a trade agreement with China and is reportedly considering extension of an officially backed line of credit for $1 billion.

It is possible that the expectations of all of these governments are exaggerated. Still, the bottom line is that we are behind in our economic and trade relations with China. We must move quickly to get ahead. The businessmen in this room know how hard it is to do so -- how hard it is to compete against others with sizeable leads in market share. Nevertheless, I am confident that we can substantially increase our share of the Chinese market.

<u>Business and Government Effort</u>

In part this confidence is bred of what I have experienced first hand: the Chinese understand the superiority of American technology and managerial skills. There is no doubt that China intends to tap into our strengths in these areas. This was made clear to me on my recent trip. The Chinese like American businessmen. They trust them. They are fully knowledgeable of the abilities of our oil companies, our mining firms, our builders, our manufacturers, our consultants.

Secondly, as I hope I made clear in my introduction, the Carter Administration is doing its utmost to encourage business with China. We have settled the claims issue so that Chinese deposits, ships, planes and goods can enter the U.S. without fear of attachment. We have initialled a trade agreement which provides for patent protection, for the facilitation of business and importantly, for the eventual extension of Most Favored Nation status to China. We have set up a Joint Ministerial Committee to facilitate the clearing away of remaining obstacles.

There can be no question of the Administration's resolve to enhance the business community's involvement in China. Nor, judging from the wave of American businessmen visiting China and the mushrooming of "doing-business-in-China workshops", can one doubt the business community's interest in this new market.

Still, there are significant obstacles which we must overcome.

The first is principally a matter between private U.S. firms the Chinese Government. In his meeting with Mrs. Kreps, Deng Xiaoping joked that one of the great problems we have in fostering bilateral trade is that China has too few laws and the United States too many lawyers. Actually this is no small matter. The Chinese are genuinely perplexed about our preoccupation with the law. To satisfy U.S. investors, and other investors as well, they must finalize a commerical code. Acceptable groundrules must be laid down on taxation, on protection from expropriation, on profit remittances, on dispute settlement and on myriad other concerns common to joint ventures and the other new forms of investment being contemplated by Beijing. Alternatively, the American business community might have to learn to take risks which the absence of traditional quarantees present, much as the Japanese and others have done. It will no doubt take time before the new operating procedures required of the Chinese Government and the American private sector are worked out to everyone's comfort.

A second problem relates to the extension of Export-Import Bank credits to China. As most of you know, Eximbank lending is covered by the restriction of the Jackson-Vanik Amendment. And under the Export-Import Bank Act the Bank cannot extend credits to Communist countries without a Presidential determination that it is in the national interest to do so.

We believe that we can get over these legal hurdles. But even as we do so, we will confront two problems. The first is that the PRC has a $26.5 million debt (principal amount) to the Eximbank that must be repaid. As Ambassador Chai knows, I briefly outlined our position on this matter to his government while I was in Beijing: until this official claim is negotiated, it is unlikely that the Export-Import Bank will be able to justify the extension of any new loans.

Second, the Bank's budget for FY 1979 is substantially allocated. Without an addition to the Eximbank budget it is unlikely that credits can be extended before October of this year.

The point is that we can't look to the U.S. Government to provide a great deal of financial resources this year. I know that this is a sensitive issue and the cause for complaint, but those are the facts, despite the nature of the competition and despite the new willingness of China to take in our business.

This does not mean that credit is unavailable. The Chinese have begun to tap the international market.

-- A five-year $750 million untied Eurodollar loan is being negotiated with a syndicate headed by a Canadian bank.

-- Another five-year $175 million general purpose loan has recently been arranged for China by two European banks.

-- Chase Manhattan recently announced a $30 million loan to finance the initial stage of a $250 million trade center in Beijing.

-- And just recently, China has obtained a commitment for a $500 million loan from an Arab consortium.

Concomitantly, U.S. banking activity in China has picked up dramatically. Fourteen U.S. banks now have established full correspondent relations with the Bank of China. And three have been given permission to set up representative offices. Given China's preference for dollar-denominated loans, I expect these and other U.S. banks will expand their banking operations in China.

In short, private sector resources are growing, if not yet plentiful. We acknowledge that a lack of Ex-Im financing will place us at a disadvantage for the immediate future -- for 1979. But that disadvantage should hopefully be minimized by private credits.

Conclusion

In conclusion, let me summarize the situation as I see it. To succeed in the Four Modernizations, China must attract investment. To succeed in attracting American investment, business must be assured of a stable environment, government efficiency and working commercial codes of conduct. To facilitate that investment the U.S. and Chinese Governments together must continue to move expeditiously toward final ratification of the trade agreements, completion of the textile, aviation and shipping agreements, and a resolution of the Eximbank issue. But that will not be enough. American banks and American businesses must be willing to invest a great deal of time and incur a substantial amount of risk in order to enter China and gain market share. The process will be an arduous one. But the rewards will undoubtedly be great.

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

FOR RELEASE AT 4:00 P.M. May 17, 1979

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $2,750 million, of 364-day Treasury bills to be dated May 29, 1979, and to mature May 27, 1980 (CUSIP No. 912793 3H 7). This issue will provide about $272 million new cash for the Treasury as the maturing issue is outstanding in the amount of $2,478 million.

The bills will be issued for cash and in exchange for Treasury bills maturing May 29, 1979. The public holds $1,089 million of the maturing issue and $1,389 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 Daylight Saving time, Wednesday, May 23, 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.

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 May 29, 1979, in cash or other immediately available funds or in Treasury bills maturing May 29, 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.

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

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For Release Upon Delivery
Expected at 9:00 a.m.

STATEMENT OF
DANIEL I. HALPERIN, DEPUTY ASSISTANT SECRETARY
OF THE TREASURY (TAX LEGISLATION)
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT OF THE
SENATE FINANCE COMMITTEE
MAY 18, 1979

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to present the Treasury Department's views regarding two bills: S. 100, which would amend the Internal Revenue Code to provide a deduction for reforestation expenses and would establish a reforestation trust fund within the Treasury, and S. 394, which would allow certain authors and artists performing services under contract with a corporation to elect to be treated as employees of the corporation for certain purposes.

S. 100

Deduction of Reforestation Expenditures

S. 100 would amend the Internal Revenue Code to allow a deduction of up to $10,000 per year for qualified reforestation expenditures.

The Administration opposes S. 100.

The timber industry, one of the most tax-favored domestic industries, is favored under the federal income tax laws in three significant ways.

First, under current law, a taxpayer may elect to treat the cutting of timber as the sale or exchange of a capital asset. Thus, the revenue from the sale of timber is taxed at preferential rates while the revenues of other product manufacturers and producers are taxed as ordinary income.

Taxation at capital gain rates reduced the taxes of the industry by an estimated $350 million in 1978. Taxes on the timber industry were reduced by $40 million in 1978 when Congress cut the corporate alternative tax rate on capital gains from 30 to 28 percent. In percentage terms this reduction in the capital gains rate was nearly 1.5 times the reduction in the overall corporate tax rate.

Second, costs incurred in connection with growing and carrying timber (after the reforestation period) are currently deducted against ordinary income. These costs represent approximately three-fourths of the total cost of raising timber.1/ This is in contrast to the general principle that an expenditure is not currently deducted if it is related to the purchase or production of an asset that will provide a benefit beyond the year the expenditure is made. Thus, plant and equipment costs are depreciated over the periods these assets are used in a business. Similarly, the cost of producing inventory for resale is not currently deducted but is reflected in income as an offset against the selling price of the goods in the year of sale.

The timber industry currently enjoys significant exceptions from this basic tax principle. For example, timber stand improvements such as brush control, thinning, pruning and shaping of trees, and costs incurred in controlling insects and disease, are treated as annual expenses although the amounts paid for these activities add to the long-term value of the timber. If the increase in the value of standing timber is not recognized until the timber is sold or cut, then the costs of earning that income should be capitalized so that income and expense are properly matched.

The third element of the current timber tax subsidy is the conversion of ordinary income into capital gains. This conversion is a result of the first two subsidies described above: capital gains treatment of timber income and the current expensing of the costs of growing and carrying timber. Such expenses are currently deducted against other ordinary income of the timber company, such as from logging or manufacturing, while the revenue ultimately produced by these expenses -- the sale of timber -- is taxed at the capital gains rates. The effect is as if the cost of the purchase of securities was currently deducted against wage income while the capital gain treatment on sale applied not only to profit but to nearly the entire proceeds of the sale.

In addition, timber growing receives special treatment under the Internal Revenue Code provisions relating to the minimum tax on tax preference income. The 1976 changes to the minimum tax for corporations increased the minimum tax rate from 10 to 15 percent, and eliminated both the carryover of regular tax as an offset to future preference income and the $30,000 exemption from the minimum tax. Timber was not subject to these changes, and we estimate the revenue loss from this special treatment to be $20 million.

These four items -- capital gain treatment of income, mismatching of income and expense, conversion of ordinary income into capital gains, and the special minimum tax provisions -- give the timber growing industry a substantial tax subsidy. A recently published study completed by the Treasury's Office of Tax Analysis[2/] estimates that these special tax preferences are equivalent to a direct cash subsidy of 35 to 43 percent of the value of standing timber.

The effect of these substantial tax subsidies also may be characterized as providing a negative income tax to the timber industry. As a result, an investment which is unprofitable before taxes yields an after-tax profit equal to the net tax savings.[3/]

In light of the substantial subsidy already provided to timber growing in the tax law, we believe a further subsdiy in the form of deductions for reforestation expenditures cannot be justified.

<u>Reforestation Trust Fund</u>

S. 100 would also require the Treasury to establish a Reforestation Trust Fund to be segregated from the general fund of the Treasury. The bill would appropriate up to $30 million a year to the trust fund during a seven-year period under the tariff schedules relating to imports of wood and wood-related products.[4/] The amounts held in the Trust Fund would be available to meet the obligations of the United States in eliminating and preventing a backlog in the reforestation of the National Forest System to the extent that amounts otherwise appropriated for any year are not sufficient to meet such obligations.[5] At the end of the seven-year period, any amounts remaining in the Trust Fund would be returned to the Treasury's general fund.

The Treasury Department is opposed to this part of the bill. The tariff rates on timber and timber products have been set to provide a determined level of aid to the domestic timber growing industry. Applying part, or all, of the tariff proceeds to reforestation work rather than using the proceeds for general governmental expenditures would enhance the effect of the tariff in benefitting the domestic industry. This would conflict with our Government's policy of negotiating for the reduction of quasi-tariff barriers to international trade. In any case, it would not be appropriate to single out those industries which are already protected by tariffs for additional benefits to be paid for from the tariff revenues. Industries without tariff protection, or nominal tariff rates on their products, could be given similar benefits only by specific appropriations from the general fund.

S. 394 -- Authors and Artists as Employees

S. 394 would allow certain authors and artists under contract who were participants in a corporation's employee pension, profit-sharing or annuity plan, to elect to be treated as employees for all purposes under the Internal Revenue Code except for the Federal Unemployment Tax Act (FUTA). The bill is intended to benefit the New Yorker magazine which has treated the individuals in question as employees for purposes of its retirement plans but not for withholding of income or FICA taxes or the payment of the employer's share of FICA and FUTA.

The New Yorker magazine has arrangements with certain artists and authors for payment of compensation based on work accepted. Under these agreements, the artists generally agree to offer their work first to the New Yorker or to use their best efforts to produce suitable work. Apparently, most of these authors and artists derive the greater part of their earned income from the New Yorker. In 1977 the IRS held on reexamination of the corporation's pension plan that these authors and artists were not employees and therefore could no longer participate in the corporation's retirement programs.

As you are aware, the Treasury and IRS have been reexamining the issue of classification of individuals who provide services for purposes of employment taxes and income tax withholding. While we have not completed that study, we think it is reasonable for the individuals with the working relationship of the authors and artists in question to be treated as employees. Accordingly, we would have no objection to this bill, provided that the authors and artists under contract with the New Yorker are treated as employees regardless of whether they make an election to be treated as such and regardless of whether they were working for the corporation as of December 31, 1977. In addition, we think that for purposes of uniformity these individuals also should be treated as employees for FUTA purposes. In other words, we think that sections 1(a)(1) and 1(a)(2) of the bill should be deleted and section 1(a) should be amended to require treatment of such authors and artists as employees for all purposes under the Internal Revenue Code, including without limitation Chapters 21, 23 and 24 of the Code (FICA, FUTA and income tax withholding).

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FOOTNOTES

1/ The average amount of carrying costs varies considerably. These costs can be expected to be quite low in the case of old-growth timber in the Northwest, while they may be quite high in the case of Christmas tree plantations. Carrying costs do not necessarily have a pattern which increases year by year. To the extent carrying charges are constant or do not increase substantially over time, the effect of mismatching income and expense is magnified. In other words, the earlier in the cycle that carrying charges are incurred, the greater the benefit from the deduction.

2/ Office of Tax Analysis, U. S. Treasury Department, Federal Tax Policy and Recycling of Solid Waste Materials 4, 25, 70 (1979).

3/ For example, suppose that an investment in timber requires costs of $200 to produce $200 of timber income. This investment yields zero profits before taxes and if income and expense are properly matched, no taxes should be paid and the investment results in zero profits after taxes. However, if an investor in the 50 percent tax bracket can deduct $200 of expenses against ordinary income, he achieves a tax savings of $100. His gain on the later sale of timber is $200, but if the gain is taxed at a capital gains rate which is one-half his ordinary tax bracket, the tax on the sale is only $50. The combination of an ordinary deduction and later capital gains has permitted the investor to pay net taxes of minus $50 on the investment. As a result, the investment which was unprofitable before taxes yields after-tax profits of $50 equal to the net tax savings.

4/ Rough and primary wood products; wood waste· lumber, flooring and mouldings; wood veneers, plywood and other wood veneer assemblies, and building boards.

5/ The National Forest Management Act of 1976, P.L. 94-588, authorizes an appropriation of up to $200 million annually to replant acreage to be cut over each year and to eliminate the backlog of lands needing reforestation.

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REMARKS BY THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
AT THE
ECONOMICS CLUB OF DETROIT
COBO HALL, DETROIT
MAY 18, 1979

We are at a historical turning point in the government's managment of the economy.

"Turning point" is a bit of jargon from ballet. In the real world, unfortunately, turning points have little grace or elegance. They are marked by confusion and uncertainty. In a word, they are messy. It is only in looking back on such periods, with the hindsight of history, that we can see the emergence of esthetically pleasing trends and patterns.

I do not have the advantage of this hindsight. But I will try anyway to make some sense of where we now stand in our national economic policymaking.

Fifteen years ago, even ten years ago, there was a very broad and deep consensus -- among both economists and enlightened politicians -- about the goals and techniques of economic management. The consensus was forged by the common experience of the Great Depression, on the one hand, and by the seminal economic theories of John Maynard Keynes, on the other.

To put it briefly and crudely, the consensus was that the government's overriding economic responsibility was to manage the level of total spending -- of aggregate demand -- in the economy. The aim was to smooth out peaks and valleys in the business cycle and to assure the steady, upward climb of employment and income. The government was to do this by raising and lowering its own spending or tax levels and by restraining or loosening up on credit. Which of these tools was the most efficient to the task was a matter of some dispute, but this was largely a debate over technical details. The <u>purpose</u> of the exercise -- the short-term management of demand -- was clear to, and agreed by, all.

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This consensus has broken down.

The Great Depression is now ancient history for most Americans. This year, for the first time, a majority of the voting age population in this country has no first-hand memory of the calamity of the the 1930's.

For most Americans, economic perceptions and instincts are, instead, colored by a decade -- the 1970's -- in which inflation has averaged almost 7 percent and has at least twice soared above the double digit mark. During the first twenty post war years, inflation averaged only 1.6 percent. This decade of the 1970's has seen tax rates escalate sharply: marginal tax rates of 40 percent or more were once applied only to the rich; today they apply to middle income groups as well. Government spending has grown from 39 percent of disposable income in 1957 to 50 percent in 1978 and has shifted away from capital construction and defense toward transfering income among groups. About one-half of the federal budget now goes to income transfers. Labor productivity growth has slowed to a crawl, growing only four tenths of one percent over the past year. Since 1973 real GNP growth per capita has averaged only 1.2 percent, about half what it averaged in the 1950's and 1960's. This has been a decade when the U.S. became enormously dependent on imported oil and when we have been persistently unable to balance our international accounts. Finally , it has been a decade of very large and stubborn budget deficits.

From all of this disparate but dismaying evidence, a powerful lesson is beginning to emerge. The lesson is gaining adherents among politicians in both parties and among professional economists of every school and stripe. The lesson is that economic policy must now deal with a great deal more than short term business cycles -- with a great deal more than fine tuning the aggregate demands placed on our existing economic resources.

The new tasks facing us come on the supply side of the economy. They involve rebuilding our capital stock, reinvigorating the growth of productivity, reasserting balance in our budgetary and trade accounts, creating a new domestic base for the energy needs of our economy, regaining our place of prominence in the world economy, and reducing the structural unemployment and cruel waste of human resources that cripple our economy at every stage in the business cycle.

This is an easy lesson to state, but a very hard one to put into practice.

The reason is that all of these great tasks take a very long time to accomplish and involve a great deal of sacrifice in the process. There is no mystery in that. We all know that spending is easy; borrowing is easy; living off our capital is easy. But: Saving and investing for the future -- putting off present consumption for the sake of a secure prosperity for tomorrow -- that is hard.

For the political system, it is nearly impossible. "Tomorrow" has no constituency. All of the pressures on our politicians require a quick pay-off. Every group clamors for instant gratification of its demands. Elections happen every few years, and it avails a politician little to plead for patience and for the long view.

In this crucial respect, President Carter is a new sort of politician. He decided early on that the old, short-term politics of instant gratification no longer suits the country's needs. He has taken enormous political risks to reorient America's policies toward the long-term, supply-side problems of the economy. I cannot tell you whether this will make for good politics. But that is not the President's ultimate concern. He is concerned with sound and responsible economics.

Let me run through a few of the major things the President has done to return our economy to fundamental soundness on the supply side.

First, and perhaps most importantly, the President has focused the entire political system on the absolute necessity of moving the federal budget toward balance. When the President raised this as a major campaign issue, many self-styled experts and sophisticates tended to scoff that budget balance was unnecessary and impossible. The scoffing has now stopped. There is now wide-spread agreement, across partisan and ideological lines, that paring back the deficit must be a paramount priority of economic policy. As for feasibility, the President has already taken an inherited deficit that exceeded $60 billion and cut it back to below $30 billion, while at the same time providing two major reductions in income taxes. Federal spending has been reduced significantly as a share of GNP, and government demands on our financial markets are being brought sharply back into line.

Second, the President has moved aggressively to return competition to major sectors of the economy. He has deregulated the airline industry, bringing about a wholesale cut in fares and a healthy expansion of service. The President is also moving to pare away deadening regulations in the trucking, railroad, and communications industries. In every area of federal regulation, the President -- often at great political risk -- has insisted that costs and benefits be brought into common sense balance. Every one of these steps makes a contribution to bringing down inflation and to rebuilding the prospects for productivity growth.

Third, the President is working on many fronts to shore up our strength in the world economy. He took bold and decisive action last fall to put a stop to the debilitating, speculative attacks on our currency's value. He has reasserted the importance of a strong and stable dollar as a pillar of U.S. economic policy. Since November 1 the dollar has risen over 20 percent against the Yen, 19 percent against the Swiss Franc, and 10 percent against the German Mark. At the same time, the President has seized hold of our foreign trade problems: he brought back to life the Multilateral Trade Negotiations, thus blocking a world-wide rush toward protectionism, and he has established a policy of vigorously promoting U.S. exports.

Finally, the President has had the courage and foresight to act -- not just to <u>talk</u>, but to <u>act</u> -- on this nation's massive energy problems. Last year, he fought through the Congress a landmark bill to settle at long last a decades-long stalemate on natural gas policy. As a consequence, for the first time in years the nation this winter was spared devastating shortages and cut-offs of natural gas.

This spring, in the same way, the President has moved decisively to break the dangerous political deadlock that has trapped our crude oil policy in muddle, rhetoric, and redtape during most of this decade. The President is dismantling in an orderly but final way the unbelievably bureaucratic regime of oil price controls that has stifled U.S. oil production and subsidized our over-consumption of foreign oil since 1973. At the same time, he is insisting that the American people get a fair share of the increasing revenues of the oil industry through a fair and tough new tax on windfall profits. The proceeds of this tax will help cushion the poor against the impact of rising prices, will help develop our mass transit systems, and will provide a critical boost to the development of new energy technologies.

Every one of these steps has been necessary to secure our prosperity for the 1980's. But every one of them has, predictably, drawn fire from special interest groups and those that care only about what they get today. These battles have shown how difficult it is politically to work hard and honestly on the real, long-term, supply-side problems of the economy. But the President, by not flinching from the task, has also shown that genuine progress is possible.

What does the future hold? Looking to the far horizon, I am very confident, for the policies that the President has put in place will guarantee the economy's fundamental health and prosperity as the 1980's unfold. But these are, quite properly, policies for the long term. For the shorter term, I can and will make no rosy promises. We are in a difficult time of transition, and it will remain difficult over the next several years. Whether we succeed in the long term will depend on whether the American people have the wisdom and patience to support the present policies in the interest of assuring a secure prosperity.

The short term outlook cannot be precisely forecast. If I have learned anything from two years as Secretary of the Treasury, it is that economists deal with an extremely cloudy crystal ball. The best economists know this. Ask one for his telephone number, and he will hesitate long before answering, cautiously, that <u>maybe</u> he can provide you with an <u>estimate</u>.

With that sound example in mind, let me glance briefly at the near-term horizon.

We are heading for a period of slower economic growth. This is proper and welcome. The economy has enjoyed a remarkably strong, four-year recovery and has recently been suffering from a growth rate that exceeds its potential. For instance, the economy expanded at a nearly 7 percent annual rate in the last quarter of 1978. That has put excessive pressures on some markets and has greatly complicated our inflation problems. So we must anticipate a slower pace of economic activity, and a slower expansion of employment, for a period of time.

This, by all indications, will not be a drastic slow-down. We neither want, need, nor expect an outright recession. But it will involve a lowering of expectations and a tightening of belts.

As this slowdown proceeds, it will help cool down the inflation. Relief on this score will also be gradual, but we expect it to be steady. The 12 and 13 percent inflation rates of recent months will not hold up. The coming moderation in economic activity will provide some relief. We also expect a slowing of beef and other farm product inflation in the last half of the year. The firming of the dollar last year will begin to moderate domestic prices later this year and next, and the very extreme increases in world oil prices this spring will not likely be repeated.

But the moderation in inflation will not be sudden or dramatic. The only quick ways to slow inflation are to precipitate a massive recession or to impose wage and price controls. Unfortunately, both of those tricks lose their magic in a few, short months, leaving the economy in a shambles that would take us years to put right. So, here again, a patient and steady course is required.

On the international side, we expect the dollar to remain stable and firm. Our trade and current account balances are moving in the right direction; we look for the current account deficit to shrink to $2-to-$6 billion at annualized rates in the first half of 1980. As the President's energy measures take hold, the 1980's should see us developing domestic sources of energy that will eventually free us from excessive and dangerous dependence on foreign oil.

As I said at the start, we are at a turning point in economics -- mid-way in a long-term transition from demand management to a rebuilding of our basic productive potential. The politics of this transition are fully as important as the economics. The great question is whether we will have the courage, wisdom, and discipline to maintain a true course, involving short-term sacrifices for long term gains that will accrue to all of us. The answer of course is that the politicians will do this if we demand it of them. If we don't, they won't.

So the question must be directed, ultimately, at you, the true governors of the country. I am confident that, in the end, the American people do have the maturity and patience to make their economy, once again, second to none in the world.

QUESTIONS AND ANSWERS BEFORE
THE ECONOMIC CLUB OF DETROIT

ROBERT M. SURDAM: The Secretary has told us that he would respond to questions. We have a number of them and here is the first one.

(Reading Question) "YOU HAVE SPOKEN OF THE UNDESIRABILITY OF MANDATORY PRICE AND WAGE CONTROLS. WHY, THEN, DO YOU FIND THE VOLUNTARY PROGRAM (WITH SANCTIONS) DESIRABLE?"

HON. W. MICHAEL BLUMENTHAL: I think the significant thing about the President's anti-inflation program is that it does not have as its centerpiece the wage and price guidelines, and certainly does not involve mandatory controls. The centerpiece of the President's anti-inflation program is a sharply reduced federal deficit, a firm lid on spending, and strong cooperation with the Federal Reserve, which is following monetary policies commensurate with this kind of tight fiscal approach. That's the centerpiece. That deals with the fundamentals.

Added to that is an effort -- a very, very difficult effort given the web of laws and regulations and statutes and legitimate concerns and interests of many different groups in our society -- to simplify and to make more cost effective the various regulations and to eliminate those that are cost-raising and inflation-producing, and not cost-effective.

Added to all of those things, there is an effort to provide guidelines and targets for labor and for business in their own self-interest and in the interest of all of us to keep some limits on the rate at which prices and wages will go up.

The key to that effort is voluntarism. It is a framework for reasoning together, and I think that you will have to admit that since the inception of that program that is, in fact, the way in which things have been approached. We reserve the right, if a company absolutely refuses to cooperate -- in fact, thumbs its nose at the government's effort to secure moderation in this area -- that we as prudent buyers will say, "Well, we will buy from others."

Now, that's a long way from mandatory controls. I think it is a very, very important distinction, and above all it must be remembered that the centerpiece is the dealing with the fundamentals, that are going to slow down our economy and reduce the rate of inflation on a more permanent basis.

ROBERT M. SURDAM: (Reading Question) "MR. SECRETARY, IS NOT THE PROPOSED WINDFALL TAX ON OIL COMPANY PROFITS A CONTINUING EVIDENCE OF THE PERCEIVED POLITICAL POPULARITY OF INCOME TRANSFER?"

HON. W. MICHAEL BLUMENTHAL: Let me say a word about the windfall profits tax, a subject on which I have spent a great deal of my time in recent weeks, since the President's announcement of April 5th. The key thing about the lifting of controls is that we are going to insure that Americans pay the true replacement cost for oil. That's painful, because it's high, but there's no getting away from the fact that we have to pay for every additional barrel of oil that we have to buy from the OPEC nations a certain price; that that price has been going up, and that until this deregulation is put into effect, as it will be June 1st, we have been charging the American consumer a lower and <u>subsidized</u> price and, as a result, we've been stimulating the consumption of a product in increasingly scarce supply at prices that are unrealistic in terms of what the world is actually charging.

Now, by lifting controls we are providing, very rapidly, major additional revenues to the oil companies. Some of these revenues are in the nature of pure windfalls, in the sense that they are not required for an expansion of production, that they could not be utilized efficiently for that purpose and that the cash flow of the companies is adequate without them. With the additional $6 billion that will be left for them, not of taxes, including the windfall profits tax, there are enough resources available, there's no question about that.

The Energy Security Trust Fund is being set up primarily to capture these windfalls for three purposes, but the principal, critical purpose is energy development. Wherever we went throughout the country, and throughout the Congress, people again and again said we must marshal the resources to put the additional money that Americans are now going to be paying for petroleum resources right back into the economy to develop other, alternative sources of energy; to hasten the day when we will no longer be as dependent as we are today on oil, and on a price that is set by a foreign cartel over which we have no influence.

So, this is not income transfer in the usual sense. It is the utilization of that money which we will all be paying to develop the new technology for shale oil, for liquefaction of coal, for gasification of coal, for developments in the nuclear field, for solar energy, for the many different ways in which we will eventually bring about a reduction in our dependence on oil.

That not only makes sense, it's good for the economy in many ways. This kind of R and D effort clearly has beneficial impact throughout the country.

There is a second purpose, and that is to use some of the money to develop mass transit systems, certainly much needed in light of the problems and shortages that exist and will continue to exist with gasoline for some time.

A small amount of the revenues is going to be utilized, and quite properly utilized in my judgment, to help cushion the impact of those higher prices for energy for those lowest income groups in the economy who are severely affected and who simply cannot affort to pay that excess $50 or $100 a year for their families in added energy cost. I'm talking about families whose average income is below something like $7,000 a year. There, believe me, every hundred dollars, counts. It counts very, very heavily. It counts for all of us, but for those people it is critical. And so a limited amount will be properly used for that purpose, because it's the fair program. But the major purposes are the ones I've indicated, and that's quite different from some of the other transfer programs that we've been referring to.

ROBERT M. SURDAM: (Reading Question) "ARE YOU CONCERNED THAT THE CURRENT GASOLINE SHORTAGE, WITH ITS ADVERSE IMPACT ON THE AUTOMOBILE INDUSTRY, COULD TRIGGER A MAJOR RECESSION?"

HON. W. MICHAEL BLUMENTHAL: We see no evidence of a major recession, and I have very little concern that there is a likelihood of one or that we are heading into one. Obviously, the gasoline shortages, particularly in California, are very worrisome and troublesome; obviously, they will have a negative impact, at least in the short run, on the automobile industry.

I don't believe that we are going to have a continuation of this, at least not to the same extent, in California or anywhere. I think things will settle down. We have had a number of factors coming together, particularly out there: a rapid rise in consumption of gasoline; the reduction in crude supplies as a result of the problems in Iran earlier in the year; and a number of other factors that are peculiar to the region. They are being worked on actively. President Carter has a program in effect and is working very hard to resolve that, to insure not only that there is enough gasoline available but also, very importantly, that there is enough heating oil in the fall so that we can not only drive our cars but also heat our homes.

ROBERT M. SURDAM: Thank you, ~~s~~ir. Though I think you spoke to this implicitly, perhaps you would wish to comment further.

(Reading Question) "DO YOU THINK OUR STANDARD OF LIVING WILL DECLINE IN VIEW OF THE ENERGY SHORTAGE?"

HON. W. MICHAEL BLUMENTHAL: If we don't pull up our socks and increase our efficiency -- our productivity -- by definition it will decline. If we continue to have productivity growth of 1% or less than 1%, certainly it will decline for some people. The only way in which the Americans can look forward to improved standards of living in the years to come is by producing more efficiently, so that our productivity rises and supply get bigger.

There may well be periods -- and that has generally been the case in the face of rapid inflation -- when in fact for a year or so the real income of many groups in the society goes down. That is why no one gains from excessive wage and price increases. You can't get ahead of the game. You think you can, but you can't.

If you go back to the mid-70's and you look at some of the labor settlements and you measure those against the rate of inflation that then ensued, you find that the unions that got the best settlements also didn't get ahead. There's no place to hide. The only way to bring inflation under control is for people to practice moderation while we work on these longer-term problems; while we bring the budget under control and, through monetary and fiscal policy and some of these other structural approaches, work on the fundamental causes of inflation.

That's why the voluntary guidelines make so much sense, for they set in fact a target that we must all have in mind and adhere to if we are to lick this problem.

ROBERT M. SURDAM: (Reading Question) "HOW DO YOU FEEL ABOUT AN AMENDMENT TO REQUIRE A BALANCED BUDGET?"

HON. W. MICHAEL BLUMENTHAL: I oppose it. I presume you mean an amendment to the Constitution. I believe that the Constitution is a vital document -- the most basic one for our form of government, and it is not lightly to be tampered with or changed. If every time we had a particular problem -- and we have had some in the 203-year history of the Republic -- we would have rushed to amend the Constitution to deal with that problem, we would not have the kind of simple, basic document, even with its amendments, that we have; we would have something that would be practically inapplicable to the modern scene.

The problem of balancing the budget is a problem of discipline and courage by the political leaders that we elect and send to Washington. There is no way in which you can mandate balance and actually achieve it if the people in the Congress do not wish to cooperate. And, if the people in the Congress wish it, then it's going to happen anyway.

I can tell you, after some 2-1/2 years in Washington, that I have a long list of shenanigans on how to get around a so-called balanced budget requirement. There is a wonderful technique called putting things "off budget." There are all kinds of emergencies that can be created. There are all kinds of ways in which things can be shifted between capital and operating accounts.

A balanced budget requirement would not work unless we wanted it to work. I do not believe, finally, that the lack of flexibility inherent in this approach makes sense, for clearly the Federal Budget is not like a company's budget; it's not like a state's budget. It's quite different than the budget of the State of Michigan, for example. The budget of the Federal Government must be managed in terms of very important macroeconomic goals. These goals do change, and you cannot design a formula beforehand, a set of rules to apply to the many different situations under which the Federal Government must manage its affairs.

There is no substitute for fiscal responsibility, the kind of responsibility that the President has been preaching and practicing. And, if the Congress is willing to operate on that basis, we will get budget balance. We'll get it, with or without an amendment. But an amendment would put us into a straitjacket that is uncalled for.

ROBERT M. SURDAM: I trust, sir, that you will remember -- as one of my regulators -- that I am only reading this question. (Laughter)

HON. W. MICHAEL BLUMENTHAL: But you picked it anyway. (Laughter)

ROBERT M. SURDAM: (Reading Question) "ARE YOU AND THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS NOW IN AGREEMENT WITH THE CHAIRMAN OF THE FEDERAL RESERVE AS TO THE LEVEL OF INTEREST RATES? HAVE RATES PEAKED?"

HON. W. MICHEAL BLUMENTHAL: I never predict interest rates, for a variety of reasons, not the least of which is that I know that whatever I think I'm likely to be wrong. I told you the crystal balls are clouded. They're just as clouded for me as they are for anyone else, and it clearly would be unwise to do that.

Let me deal with the first part of the question, which is the more interesting one perhaps.

There has never been any disagreement. The remarkable thing about the present situation is the degree of consensus that exists between the President's principal economic advisers on the proper thrust of economic policy for this country on the one hand, and that viewpoint as seen from the vantage of the Federal Reserve Board and the Open Market Committee on the other. And I think you can see from the kind of policies that have been followed in the fiscal and on the monetary policy side how closely they have dovetailed in the past.

Now, I have breakfast with the Chairman of the Fed regularly -- at least once a week and often more frequently. We talk about many things. We talk about many things that are up for consideration that week. We exchange viewpoints and of course, when it comes to particular decisions at particular points in time, we exchange views and ideas, and it would be frightening if on every issue we always agreed 100%.

This Board is independent, this Board makes decisions. I think they have been the right decisions, and they make their decisions based on all the evidence and we are very satisfied with the way things have been going. I think we have an excellent Chairman. We get along very well with him and he, hopefully, reasonably well with us. And I think it's serving the country well.

ROBERT M. SURDAM: (Reading Question) "HOW DO YOU SEE THE FUTURE FOR THE DOLLAR."

HON. W. MICHAEL BLUMENTHAL: The dollar came under considerable pressure last year and late in 1977 for certain fundamental reasons that had to do with the perception in the world that our trade balance was turning very adverse and, indeed, last year, as you know, we wound up with a $35 billion adverse balance of trade; that, accordingly, our current account balance would be very adverse, and we wound up with a very heavy deficit in the current account.

There was also a perception that the rate of inflation was increasing in the United States, and perhaps a lack of certainty as to what the Administration -- that was still struggling to bring down a rate of unemployment in excess of 8% that it had inherited, would do about those problems of external accounts and rising inflation.

In addition, there is no doubt that the weakening of the dollar last year was accentuated by speculative movements that had no substance in any kind of fundamentals or reality. The counterpart of course to the weakness in the United States was the strength in the current accounts and the trade balances of other countries, particularly Germany and Japan and the Swiss, who were running very large surpluses -- which were in a sense the counterpart to our deficit.

Since November 1st of last year, when the President put in place a major program to change that situation, the realization has, I think, become widespread that our current and trade accounts are substantially better and are continuing to improve; the realization that the correct long-term solutions to the inflation problem are underway; the realization that the President clearly has identified inflation as Public Enemy Number One, and as the major preoccupation of his economic program to which he must address himself.

And also, frankly, a realization abroad that we are addressing our energy problems. Last year we had trouble generally when the Congress drafted its feet and wasn't acting on the President's energy program, it reflected itself in currency markets. The fact that we did get legislation, the fact that there are now follow-up proposals before the Congress, and the Congress will be acting on them -- all that has given much greater confidence to foreign observers of the American scene.

And, of course, there is the corollary; namely, that some other countries have reduced their surplus and that, to some extent, some of the inflation problems that we are having are also being felt elsewhere.

What all that adds up to is that we have had much greater stability -- with the cooperation that we've been able to work out with the financial authorities in Germany and Switzerland and Japan and elsewhere. We have much greater stability, a much better tone in the market. I see no reason why that should not continue. And let me just add that we are determined to keep it that way; that we have the resources and the machinery in place to insure that that be so, and I think it will be.

ROBERT M. SURDAM: (Reading Question) "WHAT STEPS HAS THIS ADMINISTRATION TAKEN TO REDUCE THE AWESOME POWER OF U.S. REGULATORY AGENCIES? THREE WEEKS AGO JOHN H. PERKINS INFORMED THIS AUDIENCE THAT REGULATORS IN 1979 WOULD SPEND 92,000 MAN YEARS PROCESSING COMPLIANCE PAPERWORK. IS RELIEF IN SIGHT."

HON. W. MICHAEL BLUMENTHAL: I commented briefly in my formal remarks that this is a subject that the President feels strongly about. Where he can, he has taken action -- airline deregulation, trucking, railroads, other areas. I emphasize where he can. Anyone of you who is at all close to this difficult area recognizes how great the limits are on the President's ability, for many of the regulations are enshrined in particular statutes enacted by the Congress, carefully watched over by powerful groups -- special groups that have interest in these particular statutes and regulations. And to get a handle on that -- to review them, to simplify them, to prune them, to reduce them -- is a very difficult and a long-term task. I think it is without question one of the structural problems that the United States faces. It is a task that must be done. We have a regulatory calendar for the first time. When we came in we found there was not even a single place in the Federal Government -- in the Executive Branch of the Government -- where you could go and look to see what regulations were up for consideration or for change. There was no place where we could measure the combined impact of different regulations promulgated by different regulatory agencies upon a single industry, whether it be the automobile industry or some other. That has been corrected. We can make these judgments now. It is going to be a slow gradual process. We are not at all satisfied that we have gone very far, but we are going steadily in the right direction.

ROBERT M. SURDAM: One final question, Mr. Secretary. (Reading Question) "WHAT ELSE SHOULD WE BE DOING TO HALT THE INFLATIONARY SPIRAL?"

HON. W. MICHAEL BLUMENTHAL: We must come to recognize that this is not a partisan problem -- it's a national problem. We must come to recognize that there are no simple solutions -- to be very suspicious of people who say, "If they only put price controls on gas, we wouldn't have this inflation." "If we only curbed the power of big unions, we wouldn't have this inflation." "If we only busted up the multinational companies, we wouldn't have this inflation."

The problem with inflation is that it has many causes and requires many, many different solutions. Some sacrifice today is the only way to lick the problem in a fundamental way. I would advise that you cooperate in an understanding way with the President's program, to fight inflation without a recession and without putting the economy into a straitjacket; cooperate with the guidelines and with the program in toto; and, finally, understand how difficult the task is.

If you do that, and if you pray a little, I think you're doing all you can. Thank you.

(Applause)

RUSSEL A. SWANEY: MR. Secretary, we're very proud to have you where you are as Secretary of the Treasury and we wish you continued wisdom. Mr. Surdam, thank you for being our Presiding Officer. Thank you all for coming. This meeting is adjourned.

ADJOURNMENT

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

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TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $5,700 million, to be issued May 31, 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 $5,909 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 March 1, 1979, and to mature August 30, 1979 (CUSIP No. 912793 2J 4), originally issued in the amount of $3,007 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $2,900 million to be dated May 31, 1979, and to mature November 29, 1979 (CUSIP No. 912793 2X 3).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing May 31, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,961 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 Daylight Saving time, Friday, May 25, 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 May 31, 1979, in cash or other immediately available funds or in Treasury bills maturing May 31, 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
THE DEPARTMENT OF THE TREASURY 1789

FOR IMMEDIATE RELEASE May 21, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,800 million of 13-week bills and for $2,900 million of 26-week bills, both to be issued on May 24, 1979, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing August 23, 1979			26-week bills maturing November 23, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.551	9.688%	10.10%	95.125 a/	9.590%	10.25%
Low	97.530	9.771%	10.19%	95.115	9.610%	10.27%
Average	97.537	9.744%	10.16%	95.119	9.602%	10.26%

a/ Excepting 1 tender of $1,100,000

Tenders at the low price for the 13-week bills were allotted 15%.
Tenders at the low price for the 26-week bills were allotted 36%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 38,290	$ 37,790	$ 51,690	$ 26,690
New York	3,406,005	2,263,005	4,510,625	2,532,205
Philadelphia	23,710	23,710	8,805	8,805
Cleveland	26,440	26,440	98,895	29,095
Richmond	28,445	28,445	24,885	17,565
Atlanta	31,875	31,875	24,905	24,905
Chicago	198,780	107,530	266,425	90,545
St. Louis	38,680	20,680	33,095	11,095
Minneapolis	6,280	6,280	4,775	4,775
Kansas City	32,770	32,770	33,250	28,070
Dallas	17,740	17,740	8,790	8,790
San Francisco	279,635	187,135	334,675	93,475
Treasury	16,770	16,770	24,265	24,265
TOTALS	$4,145,420	$2,800,170	$5,425,080	$2,900,280
Type				
Competitive	$2,595,935	$1,250,685	$3,961,630	$1,436,830
Noncompetitive	468,105	468,105	304,125	304,125
Subtotal, Public	$3,064,040	$1,718,790	$4,265,755	$1,740,955
Federal Reserve and Foreign Official Institutions	$1,081,380	$1,081,380	$1,159,325	$1,159,325
TOTALS	$4,145,420	$2,800,170	$5,425,080	$2,900,280

1/Equivalent coupon-issue yield.

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

STATEMENT BY
THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY
COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE
May 22, 1979

Mr. Chairman, I understand that you wish these hearings to focus on the vital international economic issues with which the U.S. is currently confronted and a description of the institutional framework through which the U.S. works to discuss or negotiate these issues.

As you have also invited a number of other Administration officials and Chairman Miller to meet with you, I would like to provide you today with an overview of the Administration's approach to the broad question of international economic policy coordination. In subsequent testimony, my colleagues will brief you extensively on the specific issues of trade, export promotion, the energy question, relations with developing countries and the role of the banks and the Eurocurrency markets in international lending.

The Need for International Economic Cooperation

Mr. Chairman, we in the U.S. have been slow to realize the extent to which the economic health of our own nation depends on the economic health of the world as a whole. To achieve our goals of high employment, relative price stability and a rising standard of living, we need a liberal, open system of international trade and capital flows. By maximizing the free flow of goods and money on a global scale we raise the potential for the real wealth of all nations. Including our own. Let me cite two examples of our dependence on an open system:

-- We are used to seeing figures that show exports amounting to only 6.5 percent of U.S. GNP and imports 8.5 percent. Yet in terms of domestic production, our dependence on trade is much larger. A decade ago we exported 7 1/2 percent of the goods we produced. Imports were also 7 1/2 percent of our

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domestic production of goods. Today we export 15 percent of the goods we produce; our imports equal about 19 percent of our domestic production. Even these simple ratios understate our dependence on trade. For some important manufacturing as well as major agricultural commodities, it ranges from one to two-thirds of total production. We cannot place these industries at risk by reining in on the liberalization of the global trading system.

-- A second example is provided by the U.S. dollar's role as a vehicle currency. Directly or indirectly, the world economic system is dependent on the U.S. money and capital market for the credit to keep the wheels of production oiled. Over two-thirds of all outstanding international banking loans are extended in dollars. Without that credit, economic production abroad would suffer, demand for our goods would fall, and with it employment and output here in the U.S.

We must work to maintain an open and liberal system of international trade and payments. To do so:

-- Our domestic fiscal and monetary policy must take account of conditions abroad, the impact of policies followed by other major nations on us, and the impact of our own policies on others;

-- We must continue our close cooperation with other major nations, doing all we can to reinforce each others' policies and thereby strengthen the world economy;

-- We must do what we can to help the poorest nations of the world meet basic human needs and become stronger trading partners. As a rich nation, we cannot be satisfied while millions of people lack adequate food and shelter, education, or health care. As a trading nation we must realize that higher income in poor nations means more export opportunities and therefore more jobs for Americans. As a leading global power, we have a self-interest and an obligation to promote stability in potentially volatile regions.

-- We must not allow ourselves to become excessively dependent on imports from a few countries of items without which our industrial machine cannot function. Let me be blunt. The industrial nations are all too dependent on a small group of countries for energy, and that dependence threatens the health of our economy and imperils our national security.

The Institutional Framework

Given the Secretary of the Treasury's role in domestic economic policy making, as well as the international monetary and financial policy making process, my department carries a major responsibility in the effort to coordinate overall economic policies among the major countries. The institutional framework for doing this is varied and is carried out at many different levels. At the highest levels:

-- Heads of state or government of the seven largest nations have been meeting about once a year. They will meet again at the Tokyo Summit on June 28-29.

-- Finance Ministers or central bank governors of 21 countries, representing all 138 nations which are members of the IMF, meet about twice a year. Governors of all members of the IMF meet annually and the Executive Board meets continuously throughout the year.

-- Foreign and Finance Ministers of the 24 largely industrial nations which are members of the OECD also meet annually, usually in June. A complex of general policy and specialized committees of the organization work throughout the year at the coordination process.

There are numerous other forums: The Multilateral Development Banks on development financing; GATT on trade issues; the International Energy Agency on energy; the UNCTAD on issues relating specifically to the developing countries. Central bankers from major countries gather monthly in Basle. Individual cabinet officers meet bilaterally with their counterparts. Chairman Miller and I meet quite frequently with our counterparts from England, Japan, France and Germany; the Under Secretary of the Treasury for Monetary Affairs is in constant touch with his counterparts in these countries on a wide variety of current issues. And joint committees headed by the Treasury have been established with the Soviet Union, Saudi Arabia and the People's Republic of China, to further our bilateral economic and financial relations with those countries.

Participation in these many forums is not vacation travel at the taxpayer's expense. It is the crucial process of international economic cooperation. For at these meetings we are able to exchange information and analysis on the policies each nation hopes to follow and the effects those policies are likely to have on others.

Where possible, agreements are reached as to what is to be done. But the final decisions on domestic economic policy are national decisions. Because the participants are sovereign, both the final decisions and the implementation of policy must be made within the political framework of each nation. Most of these countries are democracies whose executive leaders are responsible to parliaments and to their people. Successful policy coordination, therefore, requires both understanding and support from legislative bodies. This is why I welcome this opportunity, Mr. Chairman, to discuss the main issues with you today.

The Current World Outlook

In one way or another all of our trading partners are having trouble coping with the complex economic situation the world finds itself in. Our deliberations at the Summit, OECD, the IMF and elsewhere make clear that to some degree the leading industrial nations all have similar problems. Let me review these briefly.

Our principal common problem is inflation. During the first twenty post war years, inflation averaged only 1.6 percent in the United States. In the 1970's the average rate of inflation has risen to almost seven percent and has at least twice soared above the double digit range. For the other industrialized countries as a group, the inflation rate in the 1960s averaged 4.2 percent and in the 1970's has averaged over 9 percent.

The problem is that the general level of inflation has risen to a dangerous point. The effects of the oil shocks of 1973/74 were clearly larger, and longer lasting, than earlier estimates suggested. And increasingly, we are beginning to pay the price for inadequate productivity and lagging capital formation, not only in the United States but elsewhere. The evidence is provided by our present predicament: capacity constraints are being reached in a number of countries much sooner than expected even when broad measures such as the unemployment figures tend to suggest over-all excess capacity. For example, in Japan and Italy automobile manufacturers cannot keep up with demand. In Canada the woodpulp, textiles and steel industries are straining. In the U.S. the aluminum and chemical industries are feeling the pinch of capacity ceilings.

Against this background the short-term outlook for inflation is a clouded one. The price hikes recently implemented by OPEC will hurt. Since January alone, the OPEC countries have raised prices by 20 percent. By rule of thumb we calculate that every 10 percent rise in OPEC prices leads to a rise of 0.3-0.4 percent in the consumer price index of American products; countries who are far more dependent on imported oil will suffer more. On top of this key irritant, we are beginning to see a strong pick-up in selected raw material prices and rising wage demands in all OECD countries. The bottom line is that the Treasury now expects inflation in the OECD area to increase by 1 1/2 percentage points in 1979 above the 1978 rate of 6.9 percent.

Another area of concern is the global balance of payments outlook. Global current account imbalances will worsen substantially in aggregate terms during the course of 1979. Led by sharply higher OPEC export earnings and retrenchment of expenditures, the OPEC surplus will likely rise to a $25-30 billion level after having virtually disappeared during the second half of last year. The sharp 1979 increase will be mirrored by a swing back into deficit by OECD countries, as their aggregate current balance moves from a $5.5 billion surplus in 1978 to a deficit of $10 billion or more.

Non-oil LDCs are expected to record a $5 billion larger deficit, and their combined deficits (excluding official transfers) could exceed $30 billion for the first time since 1975.

This shift in payments balances will lead to financial strain in some countries. Yet, at the same time, it is important to note that there should be significant improvement in the distribution of external balances within the OECD area, which will tend to add stability to an otherwise very difficult situation. The surpluses of Japan, Germany, and Switzerland will decline. Their combined surpluses will still be very large, perhaps more than $15 billion, but more tolerable than the $30 billion of 1978. At the other end of the spectrum, the U.S. current account deficit should be substantially smaller than last year's $16 billion figure.

This improvement in payments relationships among the major countries is more than coincidence. Such an improvement has been a principal aim of our efforts at earlier Summits, in the IMF and OECD, and in our bilateral discussions with the countries involved. We have in particular worked intensively with Japan to find ways of reducing the large Japanese current account surplus -- globally and bilaterally with the United States -- and to remove the strains to the system arising from that source. These various efforts are now producing welcome results. But they have to be sustained and carried through.

Mr. Chairman, it is clear from these two examples that the economic health of the industrial, and by extension of the developing, world is jeopardized by the concentration of power within the OPEC. Realistically, there is scant leaway for alleviating this situation as long as consumption in the industrial countries is so high and production so low. It is to this end that the President has moved to phase out price controls on domestic crude oil. The President's bold move has the support of all OECD countries. It will provide incentive to expand domestic production to the relief of the world oil market. And it will encourage the substitution of other energy sources, to the benefit of all nations.

A second initiative that has been taken is the pledge by the members of the International Energy Agency to reduce petroleum consumption by the fourth quarter of this year by 5 percent or 2 million barrels per day below levels expected prior to the 1979 OPEC price measures.

The IEA is also investigating the potential for increased utilization of coal as a replacement for oil. This and the 5 percent pledge are being discussed today in Paris at the ministerial level.

The subject of energy, and of OPEC, will continue to be the focus of attention in international economic forums, including the Tokyo Summit where we expect the discussion to concentrate on further ways to increase energy production of all kinds and new ways to further reduce consumption.

International Monetary Issues

The shifts in energy, inflation and balance of payments situations of individual countries are, and will continue to be, reflected in the foreign exchange markets. Today as always, international monetary cooperation is key to managing the changes and pressures which develop in the global economy. Late last year, for example, the dollar fell so sharply on the exchange markets that fear and speculation took over and threatened the stability of the system as a whole. A series of forceful domestic economic actions by our own government, combined with a coordinated program of exchange market intervention by the U.S. and the central banks of Germany, Switzerland and Japan, turned that situation around.

The dollar is currently strong. And the exchange market is better balanced. The one disorderly factor in the market in recent weeks has been a sudden erratic weakness of the Japanese yen, primarily reflecting sensitivity over Japan's energy dependence.

From a systemic viewpoint, the international monetary system has been the target of a good deal of criticism in the last two years. The improved conditions in the foreign exchange market today and the prospect of better payments balance among the major industrial countries provide an opportunity to consider measures to strengthen and guide the evolution of the system.

There are two related areas of concern in the international monetary system: the Eurocurrency market and the so-called "dollar overhang."

The initial impetus to the rapid growth of the Eurocurrency market was provided by the imposition of captial controls by the U.S. in the 1960's. The competitive advantages of the market, together with the need to finance the large current account deficits which have emerged in the wake of oil price increases, have enabled it to flourish even after removal of our controls. Estimates of the size of the Eurocurrency markets in 1978 vary from $600 billion to $800 billion.

Most observers appreciate the extremely useful and efficient role played by the Euromarket in channeling funds from surplus to deficit countries, thus helping the world avoid severe deflation and direct restrictions on trade and payments. But there has also been considerable debate over whether the Euromarket's expansion is, or may become, excessive, and whether curtailment of some of its advantages over domestic markets is advisable.

In a nutshell, the problem with the Euromarkets is that they are not subject to the same degree of control as domestic money markets. They are viewed by critics as an uncontrolled source of credit expansion. This allegedly complicates monetary policy and counter-inflationary efforts.

It is not clear whether the Euromarket is an engine of excessive credit creation which aggravates world inflation, or essentially a highly efficient intermediary reallocating funds from lenders to borrowers. Certainly, a large part of new international lending has been channeled through the Euromarket. Despite its growth, Euromarket credit to final borrowers is still only a fraction of total funds raised in domestic banking markets -- in the case of dollar credit, on the order of 15 percent over the 1974-78 period. But it is a growing fraction, and its relation to domestic and international money and credit flows needs to be carefully assessed.

Chairman Miller and Under Secretary Solomon have been engaged with their foreign counterparts in a careful assessment of this market. Discussion has centered on whether additional measures are needed to help assure that the Euromarkets do not work to erode domestic money and credit policies. At the very least, there appears to be a consensus that supervisory techniques must be strengthened. The Comptroller of the Currency has taken a number of steps to improve oversight of the foreign lending practices of U.S. bank branches abroad, including implementation of a comprehensive reporting system on their activities. Similar efforts are being considered by others. And a variety of additional measures -- including the introduction of a minimum reserve requirement on Eurocurrency deposits -- are also being considered. This is an area that deserves careful attention in the period ahead.

With regard to the so-called "dollar overhang," the decline of the dollar in the foreign exchange market led some to question whether the existence of large dollar balances held abroad constitutes an important source of instability in the international monetary system. Some $225 billion are held by central banks in official accounts and another $400 to $600 billion are held in private hands. It is clear that sudden shifts of ownership of foreign dollar balances can and sometimes do add importantly to pressures and instability in the exchange markets, though it is not clear that the existence of these large foreign-held balances in and of itself is a major problem.

The experience of last fall and in the period following the November 1 measures suggests that expectations and perceptions about our underlying economic policies, performance and outlook have been the dominant considerations influencing decisions on the dollar. Moreover, this experience has reaffirmed that there is enormous scope for capital movements leading to exchange market pressures quite independent of the existing stock of foreign dollar balances. Thus, while moves to reduce the international role of the dollar may have some positive impact on market perceptions and behavior, I do not believe such steps can get at the root cause of exchange market problems.

Nevertheless there is much debate over whether a "substitution account" should be established by the IMF through which dollars could be exchanged for SDR denominated claims. The United States is fully willing to consider such a substitution account, but only as a step in the evolution of the monetary regime toward an SDR-based system. We do not consider the substitution account an emergency support effort for the dollar.

Mr. Chairman, any discussion of the Eurocurrency situation and the substitution account tends to become esoteric. I shall be glad to expand upon these subjects if you wish. The point is that efforts such as these to strengthen and guide the evolution of the international monetary and financial system can make their contribution to greater stability, and they deserve our careful attention. But we ultimately have to come back to the basic point that the primary focus must be on the fundamental factors of economic performance in individual countries, and to the task of coordinating macro-economic policy -- fiscal policy, monetary policy and to some extent what is called incomes policy. The industrial countries must work at the development of mutually supportive economic policies constantly in their efforts to achieve stability and a healthy world economy.

The Forthcoming Summit Meeting

The Summit forum is a key part of this process. Ambassador Owen will be briefing you in detail on the forthcoming Tokyo Summit. The Summit is expected to focus on energy, economic policy and relations with the developing nations. While there will also be a review of progress in the trade and monetary areas, they will not receive the main emphasis.

On energy, as I said earlier, we would expect the discussion to concentrate on ways to increase energy production and further reduce consumption.

On macro-economic policy, we would expect the discussion to include both short-term growth and anti-inflation prospects for the world economy; policies to avoid protectionism and foster adjustment; and medium-term structural adjustments in our economies which will help to produce a more stable pattern of payments balances.

Last year at Bonn there was heavy emphasis on commitments with respect to the short-term orientation of policy -- specific growth targets for Japan and Germany, anti-inflation pledges for others, etc. This year there is a feeling that the short-term policies of the participants are generally appropriate to their situations and no major changes in direction appear in prospect. What has become apparent is that several countries need to modify policies now to achieve the gradual changes in the structure of their trade which will be essential in the somewhat longer term. The U.S., for instance, must put more emphasis on exports. Japan should reorient more toward production for the domestic economy. And all Summit nations, especially the U.S., must find new ways to strengthen productivity and enhance capital formation in order to assure non-inflationary growth in the future.

On relations with the developing countries -- the so-called North/South issues -- we would expect the discussion to cover any common objectives in the upcoming UN negotiations on a development strategy for the Third Development Decade.

Development Finance

Let me linger on the developing countries for just a moment. The issues which concern the developing nations so heavily -- fluctuations of commodity prices, levels of resource transfers from industrial countries, relief from debt burdens, weight in the councils of international institutions -- are currently being discussed in a month-long conference of UNCTAD in Manila. The interest of the developing nations are highly diverse, and it is difficult for these countries to agree on the specifics which must be developed to flesh out their generalized goals. There is often a failure to appreciate the practical limitations either on the volume of aid which the industrial countries are prepared to provide or on their own capacity to absorb and utilize aid effectively. Under Secretary Cooper will review these issues for you in more detail.

The major instrument which the U.S. has been using to promote the economic development of the poorer nations of the world has been the multilateral development banks: the World Bank group, the Inter-American and Asian Development Banks and the African Development Fund. This is another area in which the primary responsibility for U.S. policy falls on the Treasury, since I serve as the U.S. Governor for each of the institutions and instruct the U.S. Executive Directors.

Last year the MDBs made loan commitments of $11 billion and disbursements for development projects amounted to $5.5 billion. However, the effectiveness and impact of the banks go far beyond the point of annual lending levels and transfers of resources. 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 in recipient countries. Through extensive programs of technical assistance, they strengthen local institutions and provide training for local officials. The longer term results of these particular activities may well be determinative of the success or failure of a country's entire development program.

But the benefits of MDB lending accure to the United States as well. Many of the countries that the banks lend to and work with are important to us for geographical or security reasons: the work of the banks lessens chances for instability which could harm our interests. And our participation in the banks is cost effective. The value of goods and services purchased from the U.S. as a direct result of MDB financing has amounted to $9.8 billion. During the period 1972-1977, U.S. GNP increased by between $2.40 and $3.40 for each dollar we paid into the banks. Between 50,000 and 100,000 U.S. jobs were created annually. U.S. exports attributable to this financing grew at an annual rate of about 20 percent.

Trade and Trade Policy

Let me turn to trade and trade policy. Our dependence on an open and liberal system of international trade and payments necessitates an active role by the Treasury in the formulation of U.S. trade policy. We must assure that both policy elements -- trade and payments -- are coordinated and consistent. The U.S. position on trade matters -- whether in bilateral negotiations or in multilateral fora such as the GATT, the OECD, or the IMF -- must reflect the totality of our international economic interest and our domestic economic policy. To this end, Treasury works closely with the STR, State and Commerce and with domestic agencies such as the CEA and COWPS in the development and the implementation of U.S. trade policy.

The whole panoply of barriers to trade has been the subject of negotiations for the last five years. This difficult but extremely important task, is now being brought to a successful conclusion.

The new agreements provide not only a substantial reduction in industrial tariffs, but also new codes governing the use of government standards, procurement and customs valuation, which should significantly reduce these non-tariff barriers to trade. Especially important to the Treasury is the new code on subsidies and countervailing measures. This code will bring much-needed discipline to one of the most contentious areas of government intervention in trade, an area where Treasury has the major operating responsibility.

For the United States, improvement in our trade performance will require more than the removal of tariff and non-tariff barriers to trade. It will require a new export consciousness. A healthy and expanding export sector is essential for the long-run stability of our external accounts and of the dollar.

We have seen significant improvement in our trade balance as growth abroad has picked up while the U.S. economy has slowed down and American businesses have taken advantage of the price competitiveness of their exports. Over the past year our trade deficit has been reduced by almost 40 percent. Indeed, between the first quarter and fourth quarter of 1978, the physical volume of U.S. exports grew at a 22 percent annual rate while the volume of imports rose at only a one percent rate.

Still more, however, needs to be done to increase U.S. exports -- both to pay for our oil and other imports and to benefit our economy as a whole.

In recognition of the importance of exports to the U.S. economy, President Carter announced a new export policy in September 1978. At that time the President announced a number of new measures designed to stimulate increased exports. These include:

-- A proposed $500 million increase in the Eximbank's direct loan authority to a record $4.1 billion for FY 1980 to help improve the Bank's competitiveness and flexibility in terms of interest rates, length of loans, and percentage of transactions financed. This is in keeping with strong Administration support for steady, sharp increases in the Bank's activities since FY 1977, when actual financing dropped to $700 million.

-- 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 possible adverse effects on our trade balance of major administrative and regulatory actions, including the use of export controls for foreign policy purposes.

Since September Eximbank has instituted new programs to encourage smaller exporters, agricultural commodity sales, and engineering and construction services. It has also undertaken major efforts to meet foreign competition by matching terms for direct loans. Also in keeping with the President's initiative, the Commerce Department has begun work on a computerized information system which will provide exporters with prompt access to international marketing opportunities abroad. Secretary Kreps will discuss these efforts and our overall export policy during her testimony.

Before concluding, I would like to say a few words about China. As you know, together with Vice-Premier Yu Qiuli of the People's Republic, I co-chair the U.S.-China Joint Economic Committee. The purpose of this Committee is to oversee and coordinate our evolving bilateral economic relationship. We have made considerable progress in the six months since the President announced the normalization of diplomatic relations. We have negotiated and signed a claims/assets settlement. We have negotiated and initialed an ad referendum trade agreement. We have begun negotiations on textiles, civil aviation and shipping. And just recently Secretary Kreps signed four science and technology accords and an agreement on trade exhibitions.

We are paving the way for American firms to do business in China. Our businesses lag far behind those of other nations in the China market. Japan has 25 percent of the total two-way trade with China. Europe has 18 percent. We have 6 percent. Our market share will grow; we expect to export nearly $2 billion in goods to China this year or roughly twice last year's volume. But while the Chinese know well the superiority of American technology and methods and will seek them out, we cannot expect trade with China to have a dramatic overnight effect on our balance of payments. The China market is a welcome addition to our export effort. Yet it is a market which will take unusual patience, skill and time to develop.

Conclusion

Mr. Chairman, I have reviewed the entire range of international economic issues. I would be glad to expand upon any of them if you wish.

Let me conclude by saying that the Carter Administration has erected over the past twenty-eight months a consistent and comprehensive international economic policy. It is a policy that ties together monetary, trade, energy, investment and North/South and East/West issues, based on a common theme of balance and the elimination of excesses -- of excessive inflation, payments imbalances, trade practices, exchange rate movements, and poverty. It is a policy rooted in responsible economic management at home. It is a policy developed and implemented in close cooperation with our allies. And it is a policy which needs the support of this Subcommittee, Mr. Chairman, and of your Senate colleagues. Thank you.

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TESTIMONY OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON THE CONSTITUTION
OF THE SENATE COMMITTEE ON THE JUDICIARY

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss with the Committee the proposed Constitutional amendments requiring either a balanced Federal budget or restricting in some way the growth of Federal outlays.

So that there is no misunderstanding about the position of this Administration toward inflation, fiscal responsibility, and the role of government versus the private sector, let me reiterate that this Administration is unequivocally committed to bringing the Federal budget into balance, and to doing so as swiftly as economic prudence permits.

Firm and continued restraint on Federal spending is the central element in achieving this commitment.

Since President Carter has taken office, we have already made impressive progress in this direction. The Federal deficit has been reduced from $66 billion in fiscal year 1976 to a projected deficit of less than $30 billion in 1980, a reduction of more than half. During this same period, the share of our national income and output devoted to Federal spending has been reduced--from 22.6 percent in 1976 to 21.6 percent in the current fiscal year, and a further reduction is proposed for 1980 and subsequent years.

A policy of fiscal restraint, reduced growth in Federal outlays, and a shrinking Federal deficit is the appropriate and necessary budget policy for today's economic circumstances, when the economy is reaching its capacity limits and inflationary pressures are accelerating. But it is clearly not the appropriate policy for <u>all</u> economic circumstances. Indeed, the moderately stimulative policy pursued over the past several years enabled the economy to recover from the deepest recession since the 1930's and to put almost 8 million Americans to work.

It is neither possible nor desirable to reduce the complex process of fiscal policy to the single constraint of budget balance. Flexibility is the necessary element of an effective fiscal strategy. Constitutionally mandating a balanced budget would undermine our efforts to develop and practice prudent economic policy.

Strict budget balance at all times, which is the mandate of most of the amendments proposed in recent months, has several major flaws.

First, the deficit varies with economic conditions that are neither wholely predictable nor wholely controllable. Congress can and does limit the aggregate level of spending. But it cannot control total receipts. While tax rates can be legislated in precise terms, taxable incomes can and do vary as total output, employment, and incomes fluctuate. Consequently, a budget that would be in balance at one level of output and income would be in deficit or surplus at other levels of economic activity. It is possible to aim fiscal policy at the objective of a balanced budget, but achieving this objective depends on a complex of factors that determinesthe economy's aggregate activity and income, a complex in which Federal spending and Federal tax rates are only partial influences.

This brings me to the second point: a rigid balanced budget mandate could exacerbate economic fluctuations. If income falls unexpectedly, then budget balance can be achieved only if tax rates are raised, or spending for the quarter of the total budget that can be controlled on an annual basis is drastically reduced. But such actions would be counterproductive because they would reduce output, employment, and incomes still further, resulting in bigger deficits which would, under a balanced budget mandate, require even larger cuts in spending and/or increases in tax rates. This is a formula for deepening recession, not for promoting economic stability.

This type of scenario cannot be dismissed as pure speculation. Although I am not overly enamored of the forecasting reliability of econometric models, I have somewhat more confidence in their ability to explain the past. Several econometric exercises show that if the Federal Government had been required to balance the budget during the 1973-1975 recession, the economic consequences would have been far more severe than they actually were. A study by the Council of Economic Advisers, using three independent econometric models, showed that if there had been mandatory budget balance during the 1973-1975 period, the unemployment rate would have risen to about 12 percent in 1975, compared with the actual rate of 8.5 percent. The number of unemployed would have increased to about 11 million during that year. Our real gross national product in 1975 would have been about 12 percent below the 1973 level. Rather than just a serious recession, the American economy would have suffered its first real depression since the 1930s.

The Federal budget can and has been used as a stabilizing tool when economic activity weakens. Annual budget balance, however, would elminate this stabilization tool. In effect, a budget balance requirement would elevate that objective above other important goals such as high employment and healthy economic growth.

Moreover, a balanced budget amendment would need very complicated escape clauses for contingencies that cannot be foreseen.

The most obvious is that of war, which brings sudden and substantial increases in defense spending. If a balanced budget requirement were in place, either taxes would have to be raised, nondefense outlays reduced, or both. A large part of nondefense outlays--almost 90 percent--are uncontrollable, however, so that the compensating outlay reductions, which could be sizable, would have to come out of a limited number of programs.

In other conceivable contingencies, a balanced budget requirement would require severe and abrupt contractions in outlay programs. A natural disaster, such as a major earthquake, might require sizable legally mandated relief expenditures that would unbalance an otherwise balanced budget. If OPEC were to raise oil prices significantly, and this had a serious impact on the economy, fiscal policy could not be used to offset the impact of the probable outflow of dollars and purchasing power from the domestic economy. An extended coal strike, railroad or truck strike, or a widespread civil disorder could have similar depressing effects on the economy which would require unanticipated outlays that would unbalance the budget. In all of these circumstances, achieving budget balance would require prompt and sometimes sizeable increases in taxes or large and destabilizing reductions in budget outlays not related to the emergency situation.

A budget amendment could conceivably be drafted that would contain sufficient exemptions and escape clauses to permit a budget to be out of balance. Indeed several of the amendments before this Committee have such provisions. However, mandating budget balance as a provision of the Federal Constitution and yet providing the necessary flexibility for emergencies would require more literary and drafting precision than anyone has the right to expect, and might well trigger extensive litigation. And, in many cases, such an amendment would either be so complicated or such a sham that it would probably accomplish less than the President has already committed himself to accomplishing.

If budget balance is mandated, it would require very precise definition of those items of receipts and expenditures that are to be counted in achieving the balance. Items that are presently classified as a "means of financing" the deficit might be reclassified as a budget receipt in order to help balance the budget, for example, seigniorage, gold sales, and savings bonds sales.

In addition, mandating budget balance would create incentives to circumvent the budget as a control mechanism.

Items could be moved off-budget, as for example were the Postal Service and the Rural Telephone Bank, thus making the federal budget less, rather than more, responsive to Congressional control. Off-budget outlays rose rapidly in the mid 1970's, from half of one percent of the budget in FY 1974 to 2.4 percent this year. The President's fiscal plans for FY 1980 and beyond reverse this trend toward increasing the number of off-budget Federal entities, but incentives to evade mandated budget balance could put us back on the path toward evasion of strict budget discipline.

Loan guarantees and insurance could replace direct loan programs so that the outlays do not affect directly the budget totals. This would be counter to the President's proposal for a new system to control the growth of Federal activities, particularly Federally guaranteed credit.

In short, any Constitutional amendment mandating budget balance would either be so filled with loopholes as to be meaningless or so rigid as to hamper the proper conduct of economic policy or national defense. Moreover, because precision of language and terminology are essential ingredients of an amendment to the Constitution, it is difficult to conceive of language that would be enduring and unchallenged over time.

In any event, the final arbiter of the content of the Federal budget could well become the Supreme Court. This would be a radical departure from our constitutional tradition which vests the Executive and Legislative Branches with the full responsibility and authority for determining tax and expenditure policy.

The budget process established by the Congressional Budget Act of 1974 has made a major contribution toward bringing about comprehensive, logical, and responsible budgetmaking. It is a vehicle fully adequate for achieving budget balance when the Congress deems it the appropriate fiscal stance. This process, which is working well in bringing the total budget under control, would be short-circuited by a balanced budget amendment.

Constitutional amendments should be reserved for matters that cannot be dealt with by any other means. The budget can be balanced without a Constitutional amendment. In fact, as I pointed out at the beginning of my statement, this Administration is moving rapidly toward a balanced budget in a prudent and sensible manner that does not involve gimmickry and does not jeopardize the economic, social, or military goals of the Nation. I do not believe that all of these goals could be achieved if an Administration were forced to abide by a Constitutional amendment requiring mandatory budget balance every year.

Mr. Chairman, I do not question the sincerity of those who propose simple solutions to complicated problems, such as how to attain our national objectives of high employment, steady growth of output, stable prices, and a strong dollar. But in the words of President Kennedy some 17 years ago, "to attain them, we require not some automatic response but hard thought." Mandatory budget balance offers no escape from our responsibility for making better discretionary decisions concerning economic policies, including decisions on spending and taxes.

Department of the TREASURY NEWS
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STATEMENT OF
DANIEL I. HALPERIN
DEPUTY ASSISTANT SECRETARY
OF THE TREASURY (TAX POLICY)
BEFORE THE
SUBCOMMITTEE ON LEGISLATIVE PROCESS
OF THE HOUSE RULES COMMITTEE
May 23, 1979

Congresswoman Chisholm and members of this distinguished Subcommittee:

It is an honor to appear before you to present the views of the Treasury Department on sunset legislation. The Administration witnesses thus far have emphasized the importance of the sunset concept as applied to government programs generally. As you are aware, government programs include tax expenditures as well as direct expenditures. If we are to gain better control over federal programs, it is essential that we examine both types of expenditures.

I will begin by discussing the general problem of tax expenditures. Then I will turn to the different ways in which the sunset concept can be applied to tax expenditures. Next, I will discuss some technical aspects of tax expenditure sunset. I will then consider some general policy matters and the criticisms most often leveled at applying sunset to tax expenditures. Finally, I will discuss H.R. 2 and H.R. 65, the bills now before you, and indicate the Administration's views in light of the goals of sunset.

It is important to note that sunset does not eliminate any tax expenditures. All sunset does is subject tax expenditures to a system of controls no more burdensome or restrictive than that which applies to direct expenditures.

B-1621

The Tax Expenditure Problem

Our government frequently turns to the tax system as a means of resolving the social, political, and economic problems of the day. For the most part, these programs take the form of tax expenditures.

The tax expenditure concept is not complicated. The federal government has two basic means by which it can carry out its programs. It can do so directly, such as by making grants and loans, or it can specially reduce liabilities otherwise owed to the government. The two methods are economically equivalent. A potential recipient can be provided the same amount of aid using either method. When the liabilities owed to the government are tax liabilities, we refer to the special reductions as tax expenditures, since they are economically and functionally equivalent to direct expenditures.

Consider a very simple example. A business owes $1 million in income taxes to the federal government. To encourage this business to undertake a project, the government has decided to provide $400,000 of direct economic assistance. The government may transfer this aid using one of the two basic methods. The business can be required to pay $1 million in income taxes and a grant of $400,000 can be made directly to the business. Or $400,000 of tax liability can be cancelled, leaving a net tax payment of $600,000. The grant would appear as a direct outlay of the government. The reduction in taxes would be treated as a tax expenditure. In either case, the business has received the same amount of economic assistance.* In the case of the tax expenditure, the federal income tax system is being used simply as a means of transferring the subsidy. In other words, the subsidy is being "cleared" -- that is, accounted and paid for -- through the income tax system.

The federal tax system is, to say the least, complicated. It is, therefore, essential to distinguish between the use of the tax system to transfer subsidies -- which I have just described -- from its basic function of raising revenues. The revenue raising function is carried out by applying a

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* To obtain equivalence, the $400,000 of tax reduction must itself be considered taxable income as a direct grant would be.

rate structure to a tax base consisting of "net income". Along with certain accounting and administrative rules, these provisions comprise the structure of the income tax system. Tax expenditures are formulated as special and distinct modifications of the basic revenue raising structure, and are separable from that structure. Superimposing tax expenditure provisions on top of tax structure provisions complicates an already complex statute. But the resulting complexity should not be allowed to cloud the important distinction between the two functions. Tax expenditures are functionally the same as direct expenditures, and should be similarly treated. The revenue raising function is a separate one, and should not be confused with the expenditure function.

Tax expenditures are used to subsidize the provision of goods and services (e.g., the charitable deduction and percentage depletion), or to subsidize the use of certain production methods (e.g., energy tax credits and the targeted jobs credit). Tax expenditures are also used to provide transfers to other governmental units (e.g., tax-exempt bonds) or to individuals (e.g., exemptions for the aged or blind).

There are now over 90 different tax expenditure programs. For fiscal year 1980, the aggregate revenue loss attributable to tax expenditures will exceed $150 billion. This is more than 28 percent of the direct budget outlays for the same year. Despite their obvious budgetary significance, tax expenditures receive minimal government control and coordination. Since a tax expenditure program takes the form of a modification of the tax laws, it avoids the budgetary checks imposed on direct expenditures, which must pass through both authorization and appropriation committees, and must compete with other programs within an agency budget ceiling. Tax expenditures are hidden within the tax law and are not counted as spending within the budget ceilings of any agency. In fact, tax expenditures have no aggregate dollar limitations. Tax expenditures are available simply by claiming an item on a tax return. They, therefore, operate as open-ended entitlement programs. Their cost is determined by the willingness of taxpayers to engage in certain economic activities. Unlike most direct expenditure programs, cost is not limited by annual appropriations. The tax committees, in effect, exercise both authorization and appropriation powers over tax expenditures, and usually do so on a permanent basis. A tax expenditure program thus avoids coming under the scrutiny of the committees most familiar with the subject matter of the program. Thus, the basic tools used to control other federal programs are, for the most part, absent from tax expenditure programs. Tax expenditures, therefore, are often easier to enact and retain than direct expenditures which accomplish the same goals.

How Does Sunset Address These Problems?

"Sunset" refers to a procedural system to compel periodic review of governmental programs. In order to make review meaningful, most programs are scheduled to terminate ("sunset") on a regular basis, thereby requiring the positive action of reauthorization to maintain the program. Sunset attempts to produce greater budgetary control by requiring periodic rejustification of government programs in order to renew spending authority.

Applying sunset to tax expenditures serves basically the same objectives as sunset generally: to provide for the evaluation of the tax expenditure in relation to the goals leading to its enactment and in light of functionally similar nontax federal programs. This facilitates program improvement and coordination with direct expenditure programs.

Sunset makes it possible to introduce a modicum of control into the chaotic tax expenditure process. The effectiveness of the control depends on the strength and breadth of the legislation, and on the willingness of the Administration and Congress to make the concept work.

There are several basic approaches to incorporating tax expenditures in some form of sunset mechanism.

A. Review only. Here, the emphasis is limited to periodic review and evaluation of tax expenditures. A schedule and criteria for reviewing tax expenditures would be established. Functionally related tax expenditures and direct spending programs would be reviewed at the same time.

The purpose of review is to provide solid information on which tax expenditure programs may be evaluated. There is a surprising dearth of information comparing tax expenditure objectives with actual results, and evaluating related tax and direct spending programs. Such review is now conducted mostly on an *ad hoc* basis in response to the political necessities of the moment. Providing such information on a regular basis will be of great assistance in formulating legislation. To the extent that review combines the efforts of the relevant substantive committees with those of the tax committees, especially in comparing the effectiveness of tax expenditures to direct spending programs, review serves a particularly useful function. However, an evaluation report, regardless of its quality and the information provided, cannot by itself guarantee Congressional consideration. The issue is whether an automatic mechanism for terminating tax expenditures is necessary to cause Congress to focus its attention on a tax expenditure.

B. Two-Step Termination Proposals. This approach, found in Title VII of H.R. 2, requires two separate pieces of legislation. The first bill establishes the termination and review structure, which is then activated to the extent provided in the second bill. The second bill is treated procedurally in much the same manner as a normal tax bill and allows the traditional tax legislative process to set termination dates and define the scope of tax expenditure sunset by use of outright exemptions or through transition, grandfathering and substitution rules.

The two-step approach has the advantage of allowing for Congressional action on the basic structure without introducing at the outset all of the controversy surrounding termination of tax expenditures. Also, by placing responsibility for determining the scope of tax expenditure sunset in the tax-writing committees, this approach tends to preserve current legislative jurisdiction.

The usefulness of this approach depends on the prospects for the second bill. Since the termination dates and exemptions set in the second bill prescribe the review structure, a review process is established only to the extent provided in the second bill. Thus, the outlook for establishing a strong review structure is tied to the willingness to provide for termination.

C. Automatic termination. The broadest possible approach to tax expenditure sunset is to prescribe termination dates for all tax expenditures in conjunction with a review process. This approach takes the most direct route to the objectives sought by applying sunset to tax expenditures. To the extent termination dates are provided, the review mechanism becomes more effective, and tax expenditures are placed more on a par with direct expenditures. There is no apparent reason why most tax expenditures should not automatically terminate unless reenacted by Congress.

D. Apply mandatory termination dates to new tax expenditures only. A variation on the previous approach is to require only that all new tax expenditures contain termination dates. This is the approach taken by Title IV of H.R. 65. Given the rate at which tax expenditures are now being enacted, such a requirement could be useful. The enforcement mechanism for this approach suggested in previous proposals is to make out of order the consideration of any bill, amendment, resolution, etc., which includes a tax expenditure and which does not contain termination provisions meeting certain requirements.

Problems of Applying Sunset to Tax Expenditures

A. Definition of a tax expenditure. The existence and definition of tax expenditures have been the subject of some debate. Yet, those responsible for applying the concept -- Treasury, OMB, the Congressional Budget Office and the Joint Tax Committee -- have been in almost complete agreement in identifying the tax expenditure items of the budget. Given this historical consistency, the actual application of sunset to tax expenditures is likely to produce few, if any, definitional problems.

B. Technical interdependencies. Elimination of one section of the tax code may affect related sections. But interdependency problems may also be created when direct expenditure programs terminate. Further, in most cases, this will be a purely technical problem, requiring careful draftsmanship and a knowledge of any concurrent changes in the tax law. In some cases, however, the interrelationships are important, and may call for broad review. The capital gains provisions are a good example of this second category. Technical interdependencies attest to the complexity of the tax code, and not to any inability to evaluate tax expenditures.

C. Transition rules. Transition rules are required when tax laws change in order to mitigate detrimental reliance on existing law. Similar examples of reliance would also be found when subsidies and other direct expenditure programs are abruptly terminated. In either case, transition rules should generally be formulated as part of the review of a given expenditure program, and not in conjunction with creating a system of review.

D. Substitution rules. If a subsitute program is not in place, automatic termination of a tax expenditure often means either the elimination of any means to accomplish a program objective or the creation of a structural "gap" in the tax law. As a result, a proposal to repeal a tax expenditure will often be accompanied by a substitute provision to accomplish the same objective or fill the "gap" (if any). For example, the President's 1978 Tax Program recommended a taxable bond option to encourage states and localities to substitute subsidized taxable borrowing for tax-exempt borrowing.

Similar substitution problems may be created by termination of direct expenditure programs. For example, if current welfare programs automatically expire, some substitute would be needed to accomplish the same goals. In some cases, however, such as foreign income deferral, where the tax expenditure may be terminated only by substituting a structural alternative, applying sunset to tax expenditures may be different from applying sunset to direct expenditures. This distinction is an extremely narrow one, and does not warrant treating all tax expenditures differently from direct expenditures.

Administration Position

In view of the general policy considerations set out above, we believe that the following decisions should guide your consideration of applying sunset to tax expenditures.

Tax expenditures are now subject to significantly less budgetary control than direct expenditures. Accordingly, we strongly urge that whatever sunset legislation is ultimately approved by the Committee not further increase the budgetary control gap between tax and direct expenditures.

At the very least, sunset legislation should provide extensive mandatory review of all tax expenditures. Tax expenditure review should be coordinated to the maximum extent possible with direct spending review. Tax expenditure review should incorporate the views of the authorization committee, and should be predicated on comparing the effectiveness of tax expenditures with related direct expenditures. We see no reason to exclude any tax expenditure from review, regardless of whether any tax expenditures are excluded from termination.

Sunset legislation should provide dates by which Congressional action will be required in order to maintain tax expenditures. This simply corrects for some of the imbalance between tax and direct expenditures and helps ensure that tax expenditure review would be meaningful.

Termination dates should be coordinated with functionally related direct expenditures.

It may be desirable, in the Committee's judgment, to exclude a few tax expenditures from the termination schedule. If the Committee is so inclined, we will be happy to work with you in examining the tax expenditure budget, and evaluating the various provisions in the light of the criteria the Committee has developed for exclusion of both direct and tax expenditures.

It is unnecessary, and may well be undesirable, for sunset legislation to include rules which may be needed in the event that specific tax expenditures are allowed to terminate. We recognize that in that event, rules might be needed to provide grandfather protection for those who relied on existing law and to substitute a direct expenditure provision or to conform the tax law to the lapse of certain provisions. However, such rules have not been included in the direct expenditure part of sunset legislation. On this basis, therefore, there is no logical reason to require such rules for tax expenditures. The sunset bill should direct that these rules be developed in conjunction with review of a tax expenditure provision as part of the evaluation of the question of termination. The choice of substitution provision (if any) should follow from the results of review, and not from a current notion of appropriateness. Finally, it does not appear worthwhile to engage now in a protracted debate on substitution and similar rules since no decision has been made yet to terminate anything.

<u>Traditional Arguments Against Applying Sunset to Tax Expenditures</u>

A. <u>Applying sunset to tax expenditures creates serious problems for business certainty</u>. It is often argued that applying sunset to tax expenditures unduly disadvantages the business community because of increased uncertainty in planning investments. Businesses will be less willing to invest if tax expenditures will be regularly reviewed and possibly terminated.

Many of those who assert this view nevertheless endorse applying sunset to <u>direct</u> expenditures. These two positions cannot be reconciled. Firms making investment decisions involving tax expenditures are in no different a position from firms who must consider whether federal spending and subsidy programs will be continued. Investment decisions are dependent on federal spending programs, such as highway construction, housing, military procurement, research and development, agriculture, and a variety of economic development programs. All of these doubtless influence business investment decisions.

Since investment is dependent on all federal programs -- direct as well as tax -- the issue really is whether such reliance should preclude regular, meaningful review of all Federal programs affecting the business community. We would submit that securing the most efficient use of Federal resources is of paramount concern. The resulting uncertainty -- if any -- can be managed by the business community, as are other investment risks. We cannot accept the proposition that all Federal subsidies to business must be provided permanently.

B. Sunset is a massive tax increase in disguise. Another argument often heard is that applying sunset to tax expenditures constitutes some sort of "backdoor" tax increase.

This argument plays upon the confusion inherent in the two roles the income tax performs -- raising revenue and providing subsidies. The income tax provisions affected by sunset are subsidies which happen to be cleared through the tax system. Accordingly, setting a termination date for a tax expenditure means nothing more than the fact that a subsidy has been scheduled to terminate. When compared with direct expenditure programs, this is surely not a novel concept. It may be that termination of some tax subsidies economically calls for a general tax cut, but only on the same grounds that would apply where terminating a direct expenditure might also justify a tax decrease.

C. Applying sunset to tax expenditures presumes that a taxpayer is only entitled to what the government doesn't tax away. The existence of government and allocation of certain functions to it means that a specified portion of national income will have to be paid in taxes. We have, in fact, decided to finance a large part of the cost of government by means of an income tax. No one suggests that this in itself presumes all income belongs to the government. Government spending may be provided either directly or by specially foregoing revenues otherwise due. Direct government action and special income tax modification are simply policy alternatives. Programs may be implemented either way. There is nothing in the tax expenditure concept any more than in the existence of an income tax that implies that the government has a "right" to income or to anything else. The tax expenditure concept simply serves to identify certain government policies more accurately, namely, as subsidies or transfers.

H.R. 2 and H.R. 65

Let me now turn to the two bills which are before the Committee.

The nontax part of H.R. 2 would establish a ten-year schedule for the mandatory reauthorization of selected federal programs, beginning on September 30, 1982. If a program is not reauthorized in accordance with the bill, there would be no further provision of appropriations, obligations, or expenditures for the program. Subsequent reauthorization of programs would take place at ten-year intervals after the initial review date. Other provisions set up review procedures, and other procedural elements for sunset.

Title VII of H.R. 2 applies to tax expenditures. I have discussed Title VII in connection with the approaches to applying sunset to tax expenditures. Title VII is the two-step approach. In the first step, a bill is passed which provides a basic structure for incorporating tax expenditures in sunset. In the second step, the bill goes through the normal tax legislative process, and allows for great discretion to the tax committees to decide what is included in sunset termination, and how. The second step is also to include transition, substitution, and other technical rules for any tax expenditures scheduled for termination.

We believe that Title VII represents a constructive step in the right direction. However, as indicated in our testimony, we would prefer a tax expenditure title that directly sets termination dates for tax expenditures. Moreover, we would not want to see technical rules, such as substitution and grandfathering provisions, included in initial sunset legislation. These rules should be the product of sunset review.

H.R. 65, introduced by Mr. Derrick, is another constructive step in the right direction. The bill would require that legislation to provide new or increased tax expenditures satisfy certain procedural requirements, such as stating the objectives of the program and providing an annual report to Congress evaluating the program in terms of its objectives. In addition, H.R. 65 would preclude consideration of a bill or a resolution providing new or increased tax expenditures for a time period exceeding five years. Thus, in effect, five-year termination would be applied to all tax expenditures covered by this provision.

Clearly, the objectives of H.R. 65, as with Title VII of H.R. 2, are consistent with our views of applying sunset to tax expenditures. We would, however, much prefer to have both review and termination apply to existing, as well as new, tax expenditures. In addition, the effect of H.R. 65 is to set a separate review cycle for new tax expenditures. This cycle may, or may not, coincide with the general functional review cycle to which the new items relate. We think it would be preferable for review and termination of new tax expenditures to be coordinated as closely as possible with existing tax expenditures and other federal programs.

Conclusion

As we have seen, subsidy programs may be formulated either as direct expenditures or as tax expenditures. The choice depends on many considerations, not the least of which are that tax expenditures are easier to enact and are not subject to review or termination.

If an effective sunset mechanism is applied to direct expenditures and not to tax expenditures, the disparity between direct and tax expenditure control will widen significantly. This will only serve to increase the pressure to enact more tax expenditures.

We cannot stress this point too much. If the Committee approves an effective sunset mechanism for direct expenditures, and does not provide a similar mechanism for tax expenditures, it will simply be shifting more of the budget control problem from direct to tax expenditures. If anything, tax expenditures now require greater budgetary control improvements than direct expenditures. We, therefore, hope that the Committee will include an effective sunset mechanism for tax expenditures in any bill that it approves.

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Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE MAY 22, 1979

Office of the White House Press Secretary

THE WHITE HOUSE

TO THE CONGRESS OF THE UNITED STATES:

For over a decade, the Federal government has limited the interest rates that savers can receive on their deposits in banks and savings institutions. In keeping with my commitment to eliminate inequitable and unnecessary regulations, I directed an Administration task force, chaired by the Treasury Department, to review the fairness, effectiveness and efficiency of these interest rate controls.

Based on the task force's findings, I am today recommending that the Congress enact comprehensive financial reform legislation. I am asking that the Congress permit an orderly transition to a system where the average depositor can receive market-level interest rates on his or her savings. I am also proposing measures to protect the long-term viability of savings institutions so that they can pay fair and competitive rates to depositors and continue their traditional role in meeting our nation's housing needs.

These actions will reform a system which has become increasingly unfair to the small saver. The present rate ceilings are costing the American people billions of dollars in lost interest annually. Our senior citizens, and others whose savings are concentrated in passbook accounts, have suffered the most. During a period of high inflation, it is particularly unconscionable for the Federal government to prohibit small savers from receiving the return on their deposits that is available to large and sophisticated investors.

The present ceilings have also contributed to sharp fluctuations in the flow of housing credit. Large cyclical swings in the availability of mortgage funds have increased housing costs and forced many prospective homebuyers out of the market during periods of high interest rates. The actions I am recommending today will help assure a steadier flow of mortgage credit for homebuyers.

Savings and loan associations exist to channel household savings into mortgages. Mutual savings banks are also major suppliers of housing credit. Because these institutions invest in long-term, fixed-rate mortgages, they are limited in their ability to meet competitive rates for savings when interest rates rise.

In 1966, interest rates rose sharply, and depositors fled many of these institutions to those able to pay higher interest rates. To prevent the failure of savings institutions and the disruption of the mortgage and housing markets, deposit rate ceilings covering commercial banks were temporarily extended to thrift institutions. The ceilings generally have been administered to permit thrift institutions to pay higher rates of interest than commercial banks.

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Conditions have changed dramatically since these limitations were first imposed on thrift institutions. In the current economic and financial environment, the ceilings have the following effects:

- o They discriminate against the small saver, who often lacks sufficient funds to purchase market-rate securities which are available to the large investor.

- o They are increasingly ineffective in maintaining deposit flows to thrift institutions. The financial marketplace is becoming adept at creating new investment alternatives, such as the money market mutual funds, which induce the small saver to withdraw his funds to obtain benefits similar to those enjoyed by the large investor. While the six-month money market certificate has succeeded in maintaining the flow of housing credit since last year, it has imposed serious pressures on thrift institutions, and it is not a long-term solution.

- o They avoid the discipline of competition and create inefficiencies in the financial marketplace. Financial institutions are limited to non-price competitive practices such as merchandising gifts, although the consumer might prefer a higher yield on his savings.

These problems cannot be solved overnight. They are rooted in the structure of our financial system, and their resolution will require a careful and deliberate approach which takes account of the realities facing our thrift institutions.

Our savings institutions have been required by law and influenced by tax incentives to invest primarily in residential mortgages. In most states, the law confines them to long-term fixed-rate mortgages. Their sources of funds -- deposits -- have considerably shorter maturities. When short-term interest rates rise sharply, revenues are limited by their earnings on the existing longer-term mortgages. Since their deposit liabilities are more volatile than their assets, they must pay depositors market rates or they start to lose their deposits.

While raising or removing the ceilings would give savings institutions the legal power to pay market rates to depositors, their economic ability to do so is still limited by the earnings from their mortgage investments. Savings institutions must be given new investment powers so that they can afford to pay higher rates and maintain the flow of mortgage credit. The transition to freer deposit rates and to new asset powers must be orderly, to avoid major shocks to the financial system.

The disparity between market rates and the ceilings is greatest during periods of high interest rates. Yet that is the time when it is most difficult for the regulatory agencies that set the ceilings to raise them substantially. These agencies are also responsible for the safety and soundness of financial institutions. If deposit interest rates rise sharply, the institutions' earnings come under great pressure unless, at the same time, their earnings are made more responsive to changing interest rates.

Accordingly, I shall ask the Congress to:

- o provide that through an orderly transition period all deposit interest rates be permitted to rise to market-rate levels. This will be subject to emergency action on the part of the responsible regulators if the safety and soundness of financial institutions is threatened or the implementation of monetary policy so requires;

- o grant the power to offer variable rate mortgages to all Federally-chartered savings institutions, subject to appropriate consumer safeguards. This authority, which would be phased in, would permit thrifts the earnings flexibility to pay competitive rates throughout the business cycle;

- o permit all Federally-chartered savings institutions to invest up to 10% of their assets on consumer loans; and

- o permit all Federally-insured institutions to offer interest-bearing transaction accounts to individuals.

These steps will bring the benefits of market rates to consumers, promote a steadier flow of mortgage credit and improve the efficiency of the financial markets.

In the interim, I support the efforts of the Federal Reserve, the FDIC, the Federal Home Loan Bank Board and the National Credit Union Administration to take steps to increase the interest rates payable to small savers. I urge them to pursue the direction begun with authorization of the six-month money market certificate, with the goal of increasing the responsiveness of the interest rate ceilings to market rates.

JIMMY CARTER

THE WHITE HOUSE,
May 22, 1979.

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epartment of the TREASURY NEWS
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FOR IMMEDIATE RELEASE May 22, 1979

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $2,260 million of $4,764 million of tenders received from the public for the 2-year notes, Series T-1981, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	9.75% 1/
Highest yield	9.77%
Average yield	9.77%

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	99.964
Average-yield price	99.964

The $2,260 million of accepted tenders includes $499 million of noncompetitive tenders and $1,284 million of competitive tenders from private investors, including 89% of the amount of notes bid for at the high yield. It also includes $477 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 $2,260 million of tenders accepted in the auction process, $239 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 May 31, 1979.

1/ Excepting 2 tenders totaling $110,000.

FOR IMMEDIATE RELEASE

REMARKS BY THE HONORABLE DANIEL H. BRILL
ASSISTANT SECRETARY OF THE TREASURY FOR ECONOMIC POLICY
BEFORE THE 64TH INTERNATIONAL PURCHASING CONFERENCE
OF THE NATIONAL ASSOCIATION OF PURCHASING MANAGEMENT, INC.
DETROIT, MICHIGAN
May 23, 1979

I'm very pleased to have this opportunity of meeting in person the people who generate some of the most important economic activity in our economy and--what is more important to those of us in the forecasting fraternity--some of the most important leading indicators of the course of economic activity. I recall the numerous occasions when your reports anticipated by a long margin the events subsequently recorded in the traditional statistics only after considerable delay. We all are deeply grateful to your group for the insights you provide into the state of the economy, and hope you will continue the good work--and continue to be right.

Insight is in particularly short supply at the moment, given the recent wide oscillations in economic activity. If economists seem to be reacting with a touch of hysteria these days, it is understandable. Indeed, the record of the past 15 months is enough to induce hysteria in a brass monkey. Look at the record: the economy stalled completely in the winter of 1978, down to zero growth; rebounded to almost a 9 percent growth rate in the spring; caught its breath with a moderate 2-1/2 percent rate of expansion during the summer; then boomed to a vigorous 7 percent expansion in the final months of the year, only to collapse to a measly 1/2 percent rate of growth in early 79. This may be some sort of record for short-term instability. If economists seem to be afflicted with a nervous disorder involving a bobbing of the head up and down, it's just the result of trying to keep track of our oscillating economy.

Where do we go from here? Since the first quarter of this year was so slow, does that automatically mean a speedup in the current quarter? Or will the economy surprise us by plunging in coming months? Or are we in for a period of somewhat greater stability in growth rates? And if so, at what level of growth?

There is a natural tendency among forecasters to extrapolate the current or most recent trends into the future, and since the most recent experience has been of a slow economy--abruptly slowing from 7 percent to less than a 1/2 percent rate of growth--it is not surprising that many economists are now forecasting a recession. But then again, most forecasters always find it hard to see sources of strength in the economy when starting from a base of slow growth. After all, as late as September of last year, following the slowdown last summer, the consensus among forecasters was that the fourth quarter of the year would show about a 3 percent growth rate. Before the year was out, it was clear that the economy had been growing at a rate more than double that of the consensus forecast.

The current pessimism seems buttressed by the behavior of the official series designated as "leading indicators". It is worth noting that the official indicator series has been falling primarily because of the inclusion in the series of the monetary components (deflated M_2 and the change in total liquid assets); most indicators of real economic performance have continued to rise. In looking for financial indicators, I for one would put more emphasis on the expansion of credit than on the behavior of a limited selection of certain categories of financial assets. For example, while the growth of the widely-watched monetary aggregates has slowed down considerably since last fall, the expansion of bank credit has continued at a strong clip, as banks have turned to nondeposit sources of funds to meet customer credit demands. And activity in the commercial paper market has soared. I think the credit figures provide more evidence of the strength of demands, and of the availability of credit to finance these demands, than does the inexplicable behavoir of the monetary aggregates.

But it is silly to pin our forecasts on the behavior of any statistical series that portray the workings of only part of a very complex economic system. There is no simple forecasting device that functions well for any period of time in a complex and dynamic society. Like it or not, we forecasters have to work for a living.

Let's for the moment dig a little more deeply into recent developments to see what clues might emerge. There are at least four major strands worth distinguishing. First, there is the consumer who has bought new autos at a strong clip so far this year, particularly imports. Admittedly, he/she may have been inspired to do so by energy developments. But the fact is that, for whatever the reason, when the consumer wanted to buy a big-ticket item, the means were there--including the credit--to make the purchase.

Second, there is the consumer who has bought little of anything else thus far in 1979. Retail sales, excluding autos and adjusting for inflation, declined by 2-1/2 percent in the first four months of the year. And residential construction also declined, but this was partly a result of the effects of severe weather.

Third, there is the business sector busily adding to inventories and capital equipment. At the manufacturing level, the book value of inventory accumulation in the first quarter was at a rate twice as rapid as in late 1978. And businesses have been ordering and spending freely for capital goods; while bad weather held up construction of factories and warehouses, growth of real outlays for producers durable equipment in the first quarter was running well above the 1978 rate.

Fourth, there are the government sectors--Federal and State and local--whose spending dropped sharply in the first quarter. Part of this is weather-related (State and local public construction), part of it is random fluctuations in the essentially volatile series on Federal outlays.

How far can we go in extrapolating these trends? Far enough to suggest slow rates of growth over the balance of the year, but not so far as to yield a recession.

Business capital outlays should continue as a source of strength for the economy. Deep order-backlogs, high rates of capacity utilization with low margins of excess capacity, the availability of funds from profits and capital consumption allowances--all these should buoy capital spending. Hopefully, inventory speculation will not continue, although with inflationary expectations strongly embedded and further work stoppages possible in a year of major labor negotiations it will take some discipline to limit so-called "precautionary" buying. I hope you gentlemen will aid the fight on inflation by resisting efforts to "buy now to beat the price rise", a self-fulfilling prophecy that dooms us all to perpetuation of inflation.

I do not look for major strength nor for significant drag from government spending this year. The Federal budget is moving gradually into a posture of more restraint, but aside from random fluctuations, should not contribute an abrupt tightening influence. State and local governments are still living in a "Proposition 13" environment, and while it is hard to see a major stimulative thrust to the economy from this sector, we appear to have experienced already as much of a stepdown in spending as is likely to develop.

The enigma, as usual in our economic system, is the consumer. Will he/she or won't he/she be back in the shops in force? There are persuasive arguments on the negative side. Real wages have been declining this year, and further increases in energy prices and fears of gasoline shortages will probably tend to keep consumer buying in low gear. Moreover, the servicing of mortgage and consumer debt is taking a record bite out of disposable incomes. And the savings rate has been below its long-term trend for so long that it's about time for the consumer to repair his balance sheet and boost his savings rate; this will mean a reduction in his spending rate.

All of the arguments are persuasive. But most of them could have been made last year too, and the consumer confounded us all. The wide quarter-to-quarter oscillations in total growth of the economy last year and into the early months of this year have mirrored the oscillations in consumer purchases of goods.

I think the dominant influence in consumer behavior will be his anticipation of the course of inflation. It is evident, from the behavior of retail sales so far this year, that the consumer has not been buying to beat inflation except perhaps in the housing area. Rather, he has been trying, albeit unsuccessfully, to restore the purchasing power of his financial assets. The savings rate did rise by about half a percentage point from the fourth quarter of last year to the first quarter of this year.

My guess is that some progress on the inflation front will provide the assurance -- as well as the real income resources -- needed to bring retail purchases back to reasonable rates of growth. And I'm hopeful on this score. We will be getting some relief on the food price front; indeed, some has emerged already. There was a steady deceleration of growth in consumer food prices at the wholesale level in the January-March period, and an actual decline in wholesale food prices in April.

Moreover, the strength of the dollar will remove one source of inflation that contributed significantly to the miserable price performance in 1978. It is estimated that as much as one percentage point of the 9 percent increase in the CPI last year resulted from the rise in costs of imports and the correlated rise in prices of domestic goods competing with imports. A strong dollar is protection against domestic inflation.

Further, the behavior of wages in recent months is encouraging -- despite all the publicity about the Teamster's settlement. The best measure we have of wages -- the hourly wage series adjusted for overtime in manufacturing and inter-industry shifts -- shows little acceleration. The push on labor costs comes from the collapse in productivity growth and some self-inflicted wounds like the minimum wage increase and higher social security taxes, not -- at least thus far -- from a push in wages.

On the other side, we still face the possibility that recent increases at the wholesale level in raw material prices and in unit labor costs will carry through to the retail level. And an attempt by labor to make up the loss in real wages resulting from the soaring inflation could result in an ending to the general moderation in wage rates thus far. The battle against inflation is far from being won. But there are a few favorable signs in an otherwise dismal and alarming price picture.

That about sums up the whole economic picture -- mixed. Not enough bad news to warrant the stampede among forecasters to a recession scenario. Not enough good news to warrant heralding an end to inflation. Not enough broad strength to warrant expectations of a strong surge in aggregate economic activity. To me it adds up to slow growth, a desirable outlook if it permits us to unwind both inflationary pressures and inflationary expectations in an orderly fashion.

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

FOR IMMEDIATE RELEASE May 23, 1979

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $2,750 million of 52-week Treasury bills to be dated May 29, 1979, and to mature May 27, 1980, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-issue Yield)
High -	90.782	9.117%	9.96%
Low -	90.727	9.171%	10.03%
Average -	90.745	9.153%	10.01%

Tenders at the low price were allotted 82%.

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

Location	Received	Accepted
Boston	$ 43,650,000	$ 28,650,000
New York	3,928,585,000	2,408,485,000
Philadelphia	2,445,000	2,445,000
Cleveland	30,340,000	15,340,000
Richmond	24,590,000	19,590,000
Atlanta	8,230,000	8,230,000
Chicago	151,030,000	41,030,000
St. Louis	39,600,000	15,600,000
Minneapolis	5,585,000	5,585,000
Kansas City	6,550,000	6,350,000
Dallas	4,245,000	4,245,000
San Francisco	355,525,000	185,525,000
Treasury	9,095,000	9,095,000
TOTALS	$4,609,470,000	$2,750,170,000

The $2,750 million of accepted tenders includes $118 million of noncompetitive tenders and $1,431 million of competitive tenders from private investors. It also includes $1,201 million of tenders from Federal Reserve and foreign official institutions in exchange for maturing securities.

B-1623

REMARKS BY THE HONORABLE DANIEL H. BRILL
ASSISTANT SECRETARY OF THE TREASURY FOR ECONOMIC POLICY
BEFORE THE 89TH ANNUAL CONVENTION OF THE TENNESSEE BANKERS ASSOCIATION
NASHVILLE, TENNESSEE
TUESDAY, MAY 22, 1979

Release on request only

A Treasury visitor always feels a certain affinity with a banking group such as yours, particularly since many of you are finally paying interest on our deposits.

Furthermore, we face common problems. Both of our institutions are caught up in the inflationary spiral, paying more for the money we raise and funneling it out to a borrowing clientele whose needs, or should one say demands, for credit are seemingly insatiable. However, we feel that we are getting a handle on our situation with the Federal budget deficit narrowing, and our own borrowing requirements clearly of manageable size. Now we await some comparable signs of moderate but effective restraint on the private borrowing and spending which is fueling inflation.

Turning to a less parochial view of the situation, it is all too clear that the dominant economic problem in this country for some time now has been an excessive rate of inflation. It undercuts economic and social progress, weakens the traditional incentives for thrift and capital formation, distorts the distribution of income, and threatens to turn expansion into contraction. Yes, there is a long list of reasons why we must achieve better control over inflation.

The behavior of prices thus far this year is nothing short of dismaying. Inflation at a 13 percent annual rate--the average for the early months of this year--is unacceptable.

Continued for long, it would undo the significant economic progress of the past two years, two years of substantial economic growth, two years of record job creation, two years of major reduction in unemployment, two years in which Federal spending has been harnessed and the budget deficit reduced dramatically. We cannot--and I am sure we will not--allow these economic gains to be dissipated by inflation.

The question, then, is not whether we will curb inflation, but how: with what tools and at what pace. There is obviously a deep public discontent with the way economic developments have been going recently. But it would profit no one to embark on an anti-inflation effort which would leave the basic problem unsolved, whatever might be the public relations benefits of seeming to take strong action. What are some of the pseudo solutions against which we must guard?

First, deliberately trying to cure inflation by recession is a nonanswer. It doesn't work. We've tried it, and the recession of 1974-75, the worst downturn this economy has suffered since the Great Depression of the '30's, didn't eradicate the inflation virus. True, it did bring inflation down out of the stratosphere, but it left a residue of underlying inflation at a rate still unacceptably high. Furthermore, it shot the Federal budget deficit up to all-time record levels from which we are just now descending.

Whatever success the recession achieved in bringing inflation down from historic highs was at the cost of over 8 million workers unemployed and over a quarter of industrial capacity idle. When the economy falls off that far, the traditional economic virtues are called into question, drastic action to get the economy moving again becomes the order of the day and the control of inflation is no longer at the top of the list of economic and political priorities. Inevitably, the government steps in and takes a range of actions to reflate the economy. If past experience is any guide, many of the government spending initiatives begun in recession would live beyond their time and burden the budget far into the future.

Another dead end road that we can rule out from the start is a program of mandatory controls. In Washington, we are genuinely puzzled by the conviction in so many circles that the economy is inexorably on the path to controls, a conviction so strong that it hardly pays to argue with those who hold it. But the basic facts are worth repeating. First, we do not have the statutory authority to impose wage-price controls, and the fight to curb inflation would be lost the day a request was made for such authority. Second, the concept of controls is repugnant to the President, to his advisors, and to a majority of the Congress. Third, no system of controls has done more than temporarily suppress inflation forces. If not supported by the appropriate macro-economic policies of restraint, and long-term policies directed at reducing costs and improving productivity, controls just delude all of us--policy makers, businessmen, labor and consumers--into confusing the suppression of symptoms with fundamental cure of illness.

Finally, we should stop the search for scapegoats to explain the inflationary process. Business blames labor, labor blames business, and the public blames its government. Certainly, the government bears an ultimate responsibility--as the public's instrument--to protect the value of the dollar at home and abroad. But the current inflation reflects a sequence of events stretching over nearly 15 years, during which time both political parties have given the control of inflation high priority.

It is naive to label the current inflation as exclusively a Washington product, or to suppose that it can be legislated out of existence. Inflation is a worldwide phenomenon, deeply rooted in most of the major industrial nations, and as threatening in its longer range implications as was the Great Depression of another era.

With the non-answers out of the way, let's focus on the basic nature of the forces involved in the current inflation problem and on the viable options for dealing with them.

Part of our current inflationary problem is simply a legacy of inflation from the past. We can't wave a wand and make that past experience disappear. Over the entire period since the mid-60's, the progression has been one of ever upward-trending inflation. With fluctuations to be sure, but with each peak and trough in inflation rates higher than the preceeding ones. Before completing the process of unwinding from one jolt to the price system, another jolt has propelled prices upward again. It is no wonder, then, that expectations of further acceleration in inflation have come to play such an important role--perhaps a dominant role--in influencing private sector economic decisions.

The consequence of this history for the mid-1970's was a game of catch-up ball. Despite the slack in aggregate demands in 1975 and 1976, labor was still trying to catch up with the food and energy price explosion of 1973. Business was adjusting prices to catch up with current and prospective wage demands and declining productivity. And these price boosts and expectations of further price boosts fueled higher wage demands for the next round of collective bargaining. It was indeed a period of wages-chasing-prices-chasing wages.

To the extent this type of tail-chasing behavior explains the persistence of inflation, a program such as the voluntary wage-price deceleration program is eminently suitable. If everyone involved in the tail-chasing game can be persuaded to chase a little slower, no one loses position, society as a whole gains. That was and is the basic rationale for the guidelines. Labor could afford to accept more moderate contract settlements, because the reduced pressure of rising wage costs would permit business to slow the rate of price increase.

It is true that the wage-price program has encountered rough going. Both consumer and wholesale prices have been rising at double-digit annual rates this year. However, it would be wrong to sell the program short, or to conclude that it has not been making a useful contribution.

The wage-price program was not designed to hold down food or energy prices, or market rates of interest. No program, voluntary or mandatory, could be expected to work in those areas. Yet it is those areas that have given the most trouble. For example, consumer prices have risen at an annual rate of about 11 percent since last September, and 13 percent this year alone. Exclusive of items largely uncovered by the program--food, energy, costs of buying, financing and maintaining a home, used cars--the rise has been at about a 7 percent annual rate since last September and roughly the same percent this year. Of course, family budgets are hit by increases in all the elements of the cost of living; but the coverage of the wage-price program has always been limited, and it makes no sense to blame the program for things it was never designed to deal with.

The bad news this year on the inflation front reflects in part special unfavorable developments in farm and food prices. Part of the sharp rise in food prices earlier was due to severe winter weather in the Midwest and strikes in California. Moreover, recent adverse and unexpected developments in the energy sector is another reason for the poor price performance. When the price-wage program was being formulated last fall we anticipated an increase in imported crude oil prices of around 7 percent. Price decisions adopted by OPEC at their December meeting and subsequent pricing decisions at the Geneva meeting in April, have placed the likely 1979 price increase for imported crude oil at more than three times our initial expectations.

Moreover, the economy surged forward with surprising strength in the fourth quarter of last year. Real growth in the fourth quarter was at an annual rate of almost 7 percent, more than double the current estimate of the economy's long-term growth potential, and well above the 5 percent average rate for the current expansion. Consumer expenditures for goods increased at a 11-1/2 percent annual rate, and business fixed investment, with a 9-1/2 percent annual rate of real growth, also showed considerable strength. This surge came after nearly four years of cyclical recovery, with only very narrow margins remaining of unutilized skilled labor and industrial capacity. We had added significant demand-pull to the cost-push, tail-chasing, feature of inflation with which the wage-price program was designed to deal.

The excessive rate of activity was reflected in costs and prices, and the impact carried over into early 1979. The GNP deflator, the most comprehensive measure of inflation we have, moved up from the 7 percent rate, to which it had settled after a bulge in the spring of 1978, to an over 8 percent rate in the fourth quarter and to around a 9 percent rate in the first quarter of this year.

Though more bad price news is anticipated for the next month or two, we do expect moderation later in the year as the impact of special factors influencing prices dissipates. Already there are some early, albeit inconclusive, signs of relief. Wholesale prices at early stages of processing for both food and non-food items actually fell in April.

The most severe feedback effects on domestic prices from last year's depreciation of the dollar are substantially complete. The rise in import prices in 1978 resulting from the decline in the dollar's exchange rate directly raised costs and indirectly provided an umbrella for increases in prices of import-competing goods. Perhaps as much as 1 percentage point of our inflation last year reflected the reduced value of the dollar in exchange markets. The strong recovery of the dollar since our November 1 actions will alleviate some of the pressure on domestic prices in 1979.

Moreover, the effect on costs of mandated increases in the minimum wage and social security taxes which went into effect at the beginning of this year will moderate as the year progresses.

Further, the tightening of the price standards, and the intensified monitoring program announced by CWPS will spread allowable price increases more evenly through the program year.

With the removal of some of the special factors affecting prices in recent months, the latest upsurge in inflation should begin to moderate. Among the more favorable signs for the inflation outlook is the slowing in economic activity that has taken place this year. Admittedly, the slowing is from a torrid pace, a pace unsustainable in an economy with very slim margins of excess capacity. Admittedly, the slowing is in part attributable to adverse weather. Admittedly, the slowing has not been uniform across the economy, but has been centered mainly in housing and in certain categories of consumer spending, while business capital spending and ordering for inventory additions have accelerated.

Nevertheless, this relief from intense demands on resources is welcome after the strains on prices set off by the surge in spending in the fourth quarter of last year. The task of governmental policies is to prevent another such surge in spending in the months ahead. We would neither anticipate nor welcome a rebound in consumer spending to the pace of late 1978, particularly when business spending for inventories is at a rapid rate. One can hope for--and legitimately anticipate--some revival in consumer spending from the sluggish pace of retail sales in the early months of this year. But it is important that the rebound be on the moderate side.

Similarily, it is important that manufacturers' accumulation of inventories, which accelerated sharply in the early months of the year, should be closely geared to sales. A major factor sustaining the recovery over the past four years has been business prudence in keeping inventories under good control and abstaining from inventory speculation. Inventory imbalance has usually been the proximate cause of the termination of a recovery, and while inventory/sales ratios are still on the low side, it doesn't take long for these ratios to move away from equilibruim.

It is clear, therefore, that curbing inflation <u>and</u> sustaining economic expansion calls for moderation in private sector behavior, along with government restraint on its own spending, lending and regulatory programs.

While some improvement in inflation is expected, we have to recognize that enduring progress requires persistent application of policies of restraint. Our objective should not only be to bring the rate of inflation down from the double-digit range, but also to set in place a complex of policies dedicated to continued, persistent reduction in inflation over time. That is why the President proposes continued reduction in the share of the nation's output absorbed by government spending. That is why we will continue to revamp our tax structure to encourage the investment needed to modernize and expand our capacity and restore productivity growth. That is why we are reexamining our regulations to insure that they accomplish our social and economic objectives in the most cost-efficient manner possible. And finally, that is why we have embarked upon a policy of phased decontrol of domestic energy prices.

Although decontrol may add slightly to our inflation problem in the short run, in the longer-term it is clearly beneficial. By discouraging domestic oil consumption, by encouraging domestic production, by investing the recaptured "economic rents" in research for new energy technologies, by strengthening the dollar in foreign exchange markets, and by freeing ourselves from the inflationary results of dependence on a cartel's pricing decisions, we will be making a long-run contribution to reducing the U.S. rate of inflation.

But equally, if not more, important to our long-run struggle against inflation is the need to improve the U.S. productivity performance. Essential to the achievement of this objective is the continued education and training of our labor force, the upgrading and modernization of our capital stock and the expansion of the share of our national resources devoted to research and development. That is why, despite the necessity for restraining the growth of federal outlays and reducing the size of the budget deficit, the fiscal 1980 budget provides for increased outlays--and in some cases for increased tax incentives--for basic research and for on-the-job training of the unemployed, unskilled and disadvantaged.

Encouraging and insuring the growth of business investment will, however, require more than mere tax incentives. It will require, above all, a stable and growing economy--free from episodes of boom and bust--and an adequate rate of return on investment.

Late last year, profits grew rapidly, as they typically do in periods of sharply rising activity. When large fourth-quarter profits increases were announced, there was a flurry of reports in the press and considerable critical comment. Now with the release of first quarter GNP statistics, the revelation that first quarter profits on the national income accounts basis actually fell by $10-1/2 billion was not nearly so newsworthy.

In the last analysis, inflation will not be cured by struggling over income shares or looking for villains. It will only be cured when all of us--government included--recognize that there is an inflationary bias in the modern economy. It is unlikely that we will change human nature in the near future or drastically restructure existing economic and financial arrangements. The only sensible course of action is to practice fiscal and monetary stability, year in and year out, while we make a gradual transition back to relative price stability.

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

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
THURSDAY, MAY 24, 1979

TESTIMONY OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

Mr. Chairman and Members of the Committee:

I appreciate the opportunity of meeting with this distinguished Committee to discuss legislation relating to Presidential powers for dealing with inflation.

The Credit Control Act of 1969 permits the President to authorize the Federal Reserve Board to regulate extensions of credit for the purpose of preventing or controlling inflation generated by the extension of credit in excessive volume. In its various provisions, the Act gives the Federal Reserve Board broad powers to allocate credit flows.

Today, you have before you two proposed bills, S. 35 and S. 389, which would remove or weaken the President's authority to move promptly to quench credit-generated inflation. S. 35 would repeal the Credit Control Act, while S. 389 would amend the Act by requiring a concurrent resolution of the Congress before the Board could exercise the provisions of the Act.

Mr. Chairman, the Administration opposes such efforts to circumscribe the President's ability to cope with economic emergencies or distortions. This is not because we see a need to exercise such authority now or in the foreseeable future. Indeed, the current economic situation does not call for selective credit controls.

But the economic situation can change rapidly. It is only prudent, therefore, that the President retain the authority to respond promptly, and if need be selectively, to disruptive changes in the composition of credit demand.

The need for such authority today is no different than it was a decade ago, when after extensive discussion of the problem, Congress enacted the Credit Control Act of 1969. The legislative history of the Act attests to the concern the Congress had then that the President have available the broadest possible spectrum of alternatives in fighting inflation, including the capability of curbing inflationary expansion of credit without unduly restricting the supply of funds for housing, small businesses and other claimants who tend to be disproportionately crowded out of financial flows when the total supply of credit is restricted.

While the financial system of our country has developed significantly in scope and flexibility in the decade since the Act was passed, and no circumstances have arisen which required invoking the authority for selective credit controls, the basic problems addressed in the Act remain: first, monetary policy works slowly, often with a substantial lag and second, monetary restraint can have a markedly uneven impact on the structure of credit flows. As long as these problems remain, the authority in the Act to limit credit expansion selectively is an important component of the government's armory of potential tools for coping with inflation in a prompt but equitable manner.

General monetary policy is a powerful tool of economic stabilization. The Federal Reserve, by controlling the volume of reserves available to the commercial banking system, can have a major impact on the total volume and cost of credit and, therefore, on the course of economic activity. But this influence is transmitted to the world of production, sales and employment with a lag. The lag is variable in length, from cycle to cycle, and often can be substantial. In the event of national emergencies, it could be essential to allocate the flow of credit quickly, to serve national defense or emergency relief efforts. The normal workings of monetary policy and the credit system could be too slow and inefficient in such situations.

Even in less dramatic circumstances, there can be occasions when it would be desirable to use a rifle, rather than a shotgun against excessive expansion of credit in an inflationary environment. One can envisage such circumstances as an economy stretching its resources, with production levels straining capacity limits, consumer usage of credit expanding rapidly in support of an excessive burst of spending, and with businesses adding to inflationary pressures by attempting to build inventories aggressively. General monetary restraint would, of course, ultimately restrain the ability of lenders to meet these consumer and business credit demands, but because of rigidities and barriers in the financial structure, other credit uses might suffer disproportionately.

Our system of housing finance, for example, depends very largely on savings and credit flows through financial intermediaries which essentially borrow short and lend long. When monetary restraint results in rising market rates of interest, these institutions are limited in their ability to retain and attract savings,because their asset portfolio turns over slowly and the rates they can offer savers is limited.

Recent changes in regulation have permitted housing finance institutions to issue short-term savings instruments competitive with market interest rates . This authority prevented serious disintermediation in 1978, permitting housing construction to continue at a high rate throughout the year. But these new instruments have increased the cost of funds to thrift institutions, narrowing--and in some cases eliminating--the spread between money costs and mortgage returns. Over an extended period, institutions with slowly-adjusting portfolios cannot be completely insulated from the competition for savings from financial instruments traded in markets which move rapidly in response to surges in inflation. If inflation were to continue in the double-digit range for long--a prospect I do not rate as likely--housing activity would once again have to bear a disproportionate share of the burden of monetary restraint.

Let me emphasize that the situations I have been describing are, fortunately, as yet hypothetical. Neither present nor foreseeable economic events suggest the need for selective credit allocation. Consumer spending, after surging in late 1978, has been modest thus far in 1979. Business outlays for additions to inventories have increased, but these should likely moderate as production schedules are adjusted to the quieter pace of sales. And housing finance and construction activity have held up remarkably well; the principal limitation on housing demand seems to be the price of housing itself.

Credit flows in this cycle have been remarkably well balanced. While aggregate credit demands were at a record high of $485 billion in 1978, it is likely that 1979 will see a decline in this total of from 10 to 15 percent. Reports on recent developments in the consumer sector show that the consumer is now adding to debt more slowly than in the past. The ratio of net extensions of credit to disposable personal income has fallen from 3.52 percent in the second quarter of 1978 to 2.58 percent in the first quarter of this year. (The previous peak of this ratio had been 2.82 percent in the first quarter of 1973.) Automobile sales, which account for a significant part of the increase in consumer credit, have slowed somewhat in the past month and should contribute to some slowing in the rise in the consumer's debt burden.

Business borrowing has been at a high level, through commercial paper and through the commercial banking system. But there is no evidence that business demands are pre-empting credit that might otherwise flow to other sectors. Indeed, with profits rising sharply in recent months, the business sector is in large measure financing itself by providing funds to banks and through the commercial paper market.

With mortgage lending holding up reasonably well and government credit demand expected to abate, the composition of total credit flows is expected to reflect a reasonable balance among the various sectors of the economy.

In conclusion, Mr. Chairman, there is not the need now, nor do our projections suggest the need in the foreseeable future for attempting to allocate flows of credit. But economic events have a way of confounding forecasters; no one last summer correctly anticipated the surge in business and consumer spending that took place in the fourth quarter of the year, or the sky-rocketing of prices in the early months of this year. The future is too uncertain to permit dispensing with tools that might help us cope with unexpected disturbances on the economic scene.

Therefore, the Administration opposes S. 35, which would repeal the Credit Control Act. We also oppose the second bill being considered by the Committee, S. 389, which would interpose the possibility of serious delays in invoking the Act by requiring Congressional approval before the Federal Reserve could implement the President's authorization. This delay would create a situation wherein lenders and borrowers could take actions to evade the intent of the controls before such controls are implemented. The initial response to the President's action would likely exacerbate the very inflationary effects of credit extension that the controls would seek to mitigate.

epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
May 24, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY TO START COUNTERVAILING
DUTY INVESTIGATION ON CERTAIN FROZEN
POTATO PRODUCTS FROM CANADA

The Treasury Department has started an investigation into whether imports of certain frozen potato products from Canada are being subsidized.

A preliminary determination in this case must be made by October 20, 1979, and a final determination by April 20, 1980.

Imports of this merchandise during 1978 were valued at about $877,000.

The investigation follows receipt of a petition alleging that manufacturers and/or exporters of this merchandise receive benefits from the Government of Canada.

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 May 25, 1979.

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B-1625

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

FOR RELEASE ON DELIVERY
EXPECTED AT 2:00 P.M., EDST
MAY 24, 1979

STATEMENT BY JOHN LANGE,
DIRECTOR, OFFICE OF TRADE FINANCE
BEFORE THE SUBCOMMITTEE OF INTERNATIONAL FINANCE
COMMITTEE ON BANKING,
HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

Introduction

Mr. Chairman, Senators: I am pleased to be here today, along with representatives of the Export-Import Bank and the Department of State, to assist you in your review of United States lending to Zaire. There is no question that Zaire is in a difficult economic situation. Zaire is a classic case of a resource rich country with great economic potential which is having very difficult growing pains. There are encouraging signs that it is making progress in stabilizing its economy and correcting some of the underlying problems, but it will be a long and difficult task.

Before reviewing some salient economic issues related to Zaire, I would like to comment briefly on the Export-Import Bank loan for the Inga-Shaba power line. As you know, the Treasury Department--in the National Advisory Council--supported the recent preliminary commitment to finance this second cost overrun. The situation reminds me of a swimmer who, having crossed two-thirds of the lake, finds the swim exhausting and decides to turn back. Not going forward with the cost overrun has all the problems of the swimmer turning back. Continuing forward is preferable to turning back.

If Zaire's economic situation were beyond control and there were no hope for improvement, the situation might be viewed differently. However, there is a reasonable chance for improvement and thus a reasonable chance for repayment of this Eximbank credit. In this connection, Treasury made its approval of this credit contingent upon a sound monetary stabilization program, supported by an IMF Standby Arrangement. Such a Standby should be in effect before disbursements of the Eximbank credit begin.

Recent Economic Developments

The balance of my comments concentrate on Zaire's external economic situation. Deputy Assistant Secretary Walker of the Department of State will be discussing Zaire's domestic economic and political developments.

In the early 1970's, Zaire rode a crest of rising prices for its exports of industrial raw materials and agricultural products, enabling it to pursue an ambitious economic development plan, of which the Inga-Shaba power line project was a part. In 1973 when the first Eximbank loan for this project was made, the swim across the lake looked very reasonable.

While the trade balance and the current account were in deficit during this period, Zaire was able to borrow from public and private lenders and to attract sufficient investment flows to maintain a healthy overall balance of payments. However, the sharp drop in export prices in the second half of 1974, combined with continued efforts to maintain the thrust of development, led to a severe deterioration in Zaire's external accounts.

From 1975 through 1978, Zaire experienced severe balance of payments deficits. The deficit on external accounts has been associated with a continued high level of demand for imported goods and services, stimulated by substantial deficits financed by the central bank. The overall central government deficit was between 10 and 12 percent of Gross Domestic Product in 1975 and 1976 but this declined to between 5 and 6 percent in 1977 and 1978. Export unit prices for copper from 1975 to 1978 hovered between 55 and 70 percent of the 1974 level, contributing to the balance of payments deficits. Moreover, declining volumes of copper exports contributed further to the deteriorating external balance.

The balance of payments deficit was financed principally by mounting arrears on current payments. As a result, Paris Club creditors rescheduled interest and principal payments falling due in 1975 through 1977 and private foreign credit naturally became hard to come by.

Recently, rising export prices, particularly for copper and cobalt, have given a mild lift to Zaire's balance of payments prospects for 1979. The value of exports may attain

1974 levels this year, chiefly on the strength of rising prices for copper and, especially, for cobalt, which are likely to represent two-thirds of Zairian exports in 1979. Nevertheless, demands on foreign exchange resources to pay for imports and the external debt service remain heavy, while inflows of private and public capital are running at low levels.

Relations with Official and Private Creditors

Before describing Zaire's relations with its official and private creditors, I would like to review briefly some basic tenets of our debt rescheduling policy:

First, a multilateral debt reorganization should be warranted only in cases where the debtor country is in default or facing imminent default on its debt servicing obligations.

Second, debt service payments extended, guaranteed, or insured by the United States Government should normally be reorganized only in the framework of a multilateral creditor club.

Third, the debt relief efforts of the official creditors can only be successful if the debtor country undertakes a stabilization program designed to correct underlying economic problems. Normally such a program is worked out in conjunction with the International Monetary Fund and supported by a Fund standby arrangement.

Finally, to avoid discriminating among creditor countries and categories of creditors, the debtor country must extend most-favored-nation treatment to all principal official creditor countries, both participants and non-participants in creditor arrangements, and seek to secure an arrangement covering its private credits on terms comparable to those negotiated for official and officially-guaranteed credits of a comparable maturity.

When Zaire's economic and financial situation reached crisis proportions in 1975 and its foreign exchange earnings proved insufficient to cover external debt servicing obligations, it took steps to develop an economic stabilization program. Zaire opened discussions with the International Monetary Fund, instituted such a program, and a one-year Standby Arrangement was approved by the Fund in March, 1976.

Zaire then turned to its official and private creditors for relief on its external debt servicing obligations. The subsequent negotiations with official creditors in 1976 and 1977 took place in the creditor club, familiarly known as the Paris Club, which is convened in such instances on an ad hoc basis in Paris under the chairmanship of the French Treasury.

At the June 1976 Paris Club meeting, the United States, Zaire's largest creditor, and ten other countries agreed ad referendum to reorganize arrearages, as well as 85% of principal payments falling due during the last six months of 1976. Total relief amounted to about $210 million, with the United States accounting for $46 million. During the negotiations the Government of Zaire stated its intention to seek a comparable arrangement with its private creditors.

In November of that year, Zaire met in London with representatives of twelve international banks acting as syndicate managers for some 120 banks with exposure in Zaire. Citibank, on behalf of the syndicated banks, agreed to try and put together a $250 million medium-term loan. In exchange Zaire was expected (1) to meet its interest payments to all the banks on schedule, (2) to place principal payments in an account for release to the banks once the new loan was available, and (3) to negotiate an IMF Standby Arrangement. (The World Bank estimates that by the end of 1976 debt to the syndicated banks amounted to $580 million, of which almost $90 million was in arrears.)

During 1977 Zaire's severe economic and financial difficulties continued. Official creditors met once again in June and December and agreed, ad referendum, to reorganize 85% of principal and interest falling due that year. Relief totalled $200 million, of which the United States rescheduled $56.5 million. The creditors also agreed to meet early in 1978 to consider the need to renegotiate 1978 maturities, depending upon developments in Zaire's balance of payments. They stressed, however, that they would act only on condition that Zaire (1) adopt an effective IMF-endorsed stabilization program, and (2) reach agreement with the syndicated banks on either a medium-term credit (as described in the London agreement), or a direct rescheduling or refinancing of private bank debt.

As Zaire has not fulfilled either condition, the Paris Club has not been reconvened. By early 1978, however, Citibank succeeded in syndicating a $220 million five-year loan to be used for essential imports. Citibank insisted Zaire meet two conditions before funds could be drawn: Zaire would have to conclude a Standby Arrangement with the IMF, and it would have to become current on arrearages of principal and interest due all commercial banks.

The financial authorities in Zaire have not accepted Citibank's offer because the country's foreign exchange is insufficient to cover arrearages of principal due private bank creditors. As a counter proposal, Zaire has suggested rescheduling or refinancing the payments of principal due. Discussions between Zaire and its private bank creditors have been suspended for some months.

International Monetary Fund Relationship with Zaire

Before reviewing the relationship between Zaire and the IMF, let me describe briefly how IMF programs are developed and implemented.

The IMF is the central monetary institution for the world economy and its resources are available to help members deal with temporary balance of payments difficulties in an internationally responsible manner. The basic goal of the IMF's support is to help ensure that the member's balance of payments problem is corrected within a reasonable period--during which IMF financing is available. A program to improve the balance of payments is developed by the member in consultation with the IMF, and IMF financing is made available on a phased basis, as the program is implemented.

Specific performance criteria are established to permit the member country and the Fund to assess progress in the implementation of the program. While these criteria are normally confined to those macroeconomic variables necessary to achieve the objectives of the program, the specifics of each program depend on the nature and cause of the member's problems. These differ from case to case. Failure by the member to meet the criteria established in the program signals the need to examine whether further measures are necessary, and triggers consultations between the member and the Fund in order to reach further understanding before additional financing is provided by the Fund.

In March 1976, the Zairian Government initiated an IMF-supported stabilization program. It depreciated the zaire by 42 percent and adopted restrictive wage and demand management policies. However, aggregate demand was not adequately restrained because the overall government deficit substantially exceeded program levels. The overall balance of payments deficit in 1976 was, therefore, $384 million, substantially higher than planned levels.

In April 1977, a second and more stringent stabilization effort was launched with the support of an IMF standby arrangement. The program called for a wage freeze, careful management of foreign exchange resources, of public and publically guaranteed borrowings, and placed limitations on external borrowing. Performance under this program fell short of expectations. Credit ceilings were substantially exceeded, as the Bank of Zaire financed higher than planned government expenditures. External arrears rose instead of declining. The disruption in production for export associated with the two Shaba invasions exacerbated these economic difficulties.

Since June 1978, the Government of Zaire and the IMF have continued to discuss a stabilization program, which might be supported by a Fund standby arrangement. To support Zaire's efforts to develop a meaningful program, both the IMF and IBRD have provided technical assistance to improving Zaire's statistical data gathering and reporting capabilities.

While we are hopeful that a program will soon be established, it is not possible now to predict when that might occur. To accelerate this effort, the Zairian Government has, with the help of the IMF, recruited a small staff of technically trained expatriates. To improve foreign exchange management in the Central Bank, the Central Bank has put in place a strict foreign exchange regime which appears to have to have been reasonably effective during its first six months.

The IMF will resume negotiations as early as possible, sometime in June, and I would expect the negotiations to be concluded as expeditiously as possible.

Linking disbursements of the Eximbank Inga-Shaba credit to a Standby Arrangement will delay progress on the project. Whether the contractor will be willing to wait that long is an open question. At this juncture, however, we believe it is a necessary condition given the history I have outlined for you.

Activities of the Multilateral Development Banks

The World Bank Group has an active long-term program in Zaire designed to promote development and the rehabilitation of the economy. Given its limited resources, the African Development Fund has made only one loan to Zaire, which was approved last year.

Since 1969 Zaire has received $222 million from the International Development Association (IDA) for transport, development finance company operations, water supply, agriculture and education projects. In 1975, the World Bank made a loan of $100 million for the GECAMINES Mining Expansion Project, which was cofinanced by the European Investment Bank and by the Libyan Arab Foreign Bank. The International Finance Corporation, which has an equity participation in the national development finance company (SOFIDE) Societe Financiere de Development, approved a $4.1 million loan for an offshore oil production project in 1978. Zaire is current on the repayment of principal and interest on its loans from the World Bank Group.

In addition to project financing, a major objective of the World Bank Group is the building of institutions capable of promoting development. The Bank has also helped encourage the design and implementation of appropriate economic policies, particularly in the agricultural, transport and education sectors. In agriculture, Bank assistance has focused on coordinating and reinforcing efforts to reverse the declining trend of agricultural output, reduce reliance on agriculture imports, and promote the exports of selected agricultural commodities.

The Bank has also played an active role in coordinating donor activities in Zaire. At a Consultative Group Meeting chaired by the Bank in June 1977, the donors strongly supported the Government's intention to give highest priority to the development of agriculture. The Consultative Group may be reconvened after the Government completes its public investment program.

Conclusion

Zaire seems prepared to take the necessary steps to stabilize its economy. Mineral export prices have strengthened, and a reasonably effective system for managing foreign exchange is in place in the Bank of Zaire.

The decision on the Inga-Shaba loan is not easy. But, with the project 80 percent completed, I believe we should swim the rest of the way across the lake. To encourage the institution of sound monetary and fiscal policies, initial disbursement of the loan should be contingent on an IMF Standby Arrangement being in place. Before changing this condition, it is the intention of the Executive Branch to consult with this Subcommittee or the Chairman again.

For these reasons Treasury recommends your concurrence with the Eximbank loan being considered by the Subcommittee today.

Thank you, Mr. Chairman.

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

FOR IMMEDIATE RELEASE May 25, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,800 million of 13-week bills and for $2,901 million of 26-week bills, both to be issued on May 31, 1979, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing August 30, 1979			26-week bills maturing November 29, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.616	9.431%	9.82%	95.269 a/	9.358%	9.99%
Low	97.585	9.554%	9.95%	95.225	9.445%	10.08%
Average	97.592	9.526%	9.92%	95.243	9.409%	10.04%

a/ Excepting 2 tenders totaling $600,000

Tenders at the low price for the 13-week bills were allotted 72%.
Tenders at the low price for the 26-week bills were allotted 23%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 26,905	$ 26,905	$ 20,105	$ 20,105
New York	3,602,615	2,262,615	3,465,235	2,367,485
Philadelphia	20,585	20,585	10,480	10,480
Cleveland	40,605	30,605	58,845	58,845
Richmond	49,355	49,355	14,320	14,320
Atlanta	36,615	36,615	26,285	26,285
Chicago	232,525	157,525	242,155	192,155
St. Louis	36,810	13,810	35,070	16,530
Minneapolis	14,525	14,525	12,580	12,580
Kansas City	32,800	32,800	15,385	15,385
Dallas	10,720	10,720	6,415	6,415
San Francisco	240,740	126,740	198,470	143,460
Treasury	17,250	17,250	16,560	16,560
TOTALS	$4,362,050	$2,800,050	$4,121,905	$2,900,605
Type				
Competitive	$2,708,995	$1,246,995	$2,708,020	$1,586,720
Noncompetitive	415,155	415,155	254,185	254,185
Subtotal, Public	$3,124,150	$1,662,150	$2,962,205	$1,840,905
Federal Reserve and Foreign Official Institutions	$1,237,900	$1,137,900	$1,159,700	$1,059,700
TOTALS	$4,362,050	$2,800,050	$4,121,905	$2,900,605

1/Equivalent coupon-issue yield.

B-1627

epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. May 29, 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 $5,600 million, to be issued June 7, 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 $ 5,837 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 March 8, 1979, and to mature September 6, 1979 (CUSIP No. 912793 2K 1), originally issued in the amount of $3,006 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 2,800 million to be dated June 7, 1979, and to mature December 6, 1979 (CUSIP No. 912793 2Y 1).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing June 7, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,553 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 Daylight Savings time, Monday, June 4, 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 June 7, 1979, in cash or other immediately available funds or in Treasury bills maturing June 7, 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.

federal financing bank NEWS

WASHINGTON, D.C. 20220

Press inquiries: 202-566-2615

FOR IMMEDIATE RELEASE May 25, 1979

FEDERAL FINANCING BANK ACTIVITY

Roland H. Cook, Secretary, Federal Financing Bank (FFB), announced the following activity for April 1-30, 1979.

Department of Transportation Guarantees

On April 2, the National Railroad Passenger Corporation (Amtrak) refinanced the $250 million outstanding under Note #16 with Note #19, which matures October 1, 1979. This note carries an interest rate of 10.215%. Also on April 2, Amtrak issued Note #20 to the FFB. This note provides Amtrak with a $200 million line of credit to October 1, 1979. Interest rates are set by FFB at the time of each advance.

Amtrak borrowed the following amounts from FFB under their other line of credit--Note #18, which matures June 29, 1979:

Date	Amount	Interest Rate
4/11	$5,000,000	10.277%
4/13	6,000,000	10.191%
4/18	6,000,000	10.01%
4/25	5,000,000	9.573%
4/30	5,000,000	10.159%

FFB lent the United States Railway Association (USRA) $600,000 on April 5 under Note #8 at an interest rate of 9.989%. Note #8 matured April 30, and the $312,611,501.21 of principal and $46,716,922.57 of interest due was refunded by a new Note #14 for not to exceed $396,716,922.57 maturing on July 31, 1979. Conrail is the recipient of funds advanced under this note.

On April 12, FFB lent USRA $500,000 under Note #13 at a rate of 8.125%. Note #13 matures December 26, 1979.

Under notes guaranteed by DOT pursuant to Section 511 of the Railroad Revitalization and Regulatory Reform Act of 1976, FFB lent funds to the following railroads:

	Date	Amount	Maturity	Interest Rate
Chicago & North Western	4/11	$1,291,650.00	11/1/90	9.388%
Trustee of Chicago, Rock Island	4/13	3,010,492.00	12/10/93	9.661%
Trustee of The Milwaukee Road	4/25	1,317,326.00	11/15/91	9.661%

Continuing Programs

FFB signed the following loan agreements which are guaranteed by the Department of Defense (DOD) under the Arms Export Control Act.

Date Signed	Country	Amount	Maturity
4/2/79	Morocco	$40,000,000.00	4/10/87
4/11/79	Jordan	67,000,000.00	3/30/88
4/11/79	Lebanon	42,500,000.00	4/15/86

Also FFB made 27 advances totalling $91,180,519.14 to 17 foreign governments under existing DOD-guaranteed foreign military sales loan agreements.

Under notes guaranteed by the Rural Electrification Administration, FFB advanced a total of $160,095,000 to 22 rural electric and telephone systems.

On April 18, FFB purchased a total of $3,865,000 in debentures issued by 5 small business investment companies. These debentures are guaranteed by the Small Business Administration, mature in 3, 5 and 10 years, and carry interest rates of 9.695%, 9.465% and 9.365%, respectively.

FFB provided Western Union Space Communications, Inc., with the following amounts which mature October 1, 1989. Repayment of these advances is secured by NASA's obligations under a satellite tracking system procurement contract. Interest is payable on an annual basis.

Date	Amount	Interest Rate
4/2	$ 400,000	9.579%
4/20	8,645,000	9.607%
4/24	2,760,000	9.666%

FFB purchased four General Services Administration participation certificates:

Series	Date	Amount	Maturity	Interest Rate
K-018	4/2	$ 989,176.90	7/15/04	9.191%
M-044	4/11	4,613,684.55	7/31/03	9.253%
L-053	4/17	905,542.59	11/15/04	9.315%
K-019	4/30	1,248,390.73	7/15/04	9.373%

Agency Issuers

FFB purchased two Farmers Home Administration Certificates of Beneficial Ownership. Interest is payable annually.

Date	Amount	Maturity	Interest Rate
4/6	$580,000,000	4/6/84	9.542%
4/18	325,000,000	4/18/84	9.637%

The Student Loan Marketing Association, a federally chartered, private corporation raised $20 million in new cash and refunded $210 million in maturing securities. FFB holdings of SLMA notes now total $1.05 billion.

The Tennessee Valley Authority (TVA) sold FFB a $25 million, 10.239% note on April 13 and a $310 million, 9.845% note on April 30. Both notes mature August 31, 1979. These sales refunded $150 million in maturing securities and provided TVA with $185 million in new cash.

FFB Holdings

As of April 30, 1979, FFB holdings totalled $56.6 billion. FFB Holdings and Activity Tables are attached.

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FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)
April 1979

Program	April 30, 1979	March 31, 1979	Net Change (4/1/79-4/30/79)	Net Change-FY 1979 (10/1/78-4/30/79)
On-Budget Agency Debt				
Tennessee Valley Authority	$ 6,260.0	$ 6,075.0	$ 185.0	$1,040.0
Export-Import Bank	7,131.3	7,131.3	-0-	563.0
Off-Budget Agency Debt				
U.S. Postal Service	2,114.0	2,114.0	-0-	-0-
U.S. Railway Association	400.5	356.9	43.6	43.7
Agency Assets				
Farmers Home Administration	26,890.0	25,985.0	905.0	4,615.0
DHEW-Health Maintenance Org. Loans	67.4	62.2	5.2	10.4
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	921.0	921.0	-0-	283.3
Small Business Administration	101.7	103.1	-1.4	-10.5
Government Guaranteed Loans				
DOT-Emergency Rail Services Act	22.4	22.4	-0-	4.9
DOT-Title V, RRRR Act	71.4	65.8	5.6	35.6
DOD-Foreign Military Sales	4,684.2	4,614.1	70.1	706.3
General Services Administration	327.3	319.6	7.8	57.2
Guam Power Authority	36.0	36.0	-0-	-0-
DHUD-New Communities Admin.	38.5	38.5	-0-	-0-
DHUD-Community Block Grant	+	+	-0-	+
Nat'l. Railroad Passenger Corp.(AMTRAK)	337.3	454.8	-117.5	-197.1
NASA	347.2	335.4	11.8	110.7
Rural Electrification Administration	5,121.8	4,961.7	160.1	930.3
Small Business Investment Companies	287.3	283.4	3.9	36.7
Student Loan Marketing Association	1,050.0	1,030.0	20.0	305.0
Virgin Islands	21.6	21.6	-0-	-0.2
WMATA	177.0	177.0	-0-	-0-
TOTALS	$56,609.6	$55,310.4*	$1,299.2	$8,532.1

+less than $.1 million

Federal Financing Bank — May 25, 1979

*total does not add due to rounding.

FEDERAL FINANCING BANK

April 1979 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
Department of Defense					
Thailand #2	4/2	$ 135,125.51	6/30/83	9.643%	
Thailand #3	4/2	878,164.00	9/20/84	9.539%	
Jordan #2	4/3	464,400.00	11/26/85	9.483%	
Taiwan #2	4/5	44,509.56	12/31/82	9.678%	
Taiwan #3	4/5	1,268,786.78	12/31/82	9.678%	
Spain #1	4/5	2,006,334.28	6/10/87	9.407%	
Colombia #2	4/9	54,000.00	9/20/84	9.548%	
Costa Rica #1	4/9	199,657.00	4/10/83	9.672%	
Greece #9	4/9	6,800,032.21	5/3/88	9.394%	
Greece #10	4/9	10,460,507.79	2/1/89	9.36%	
Morocco #5	4/10	16,626,900.00	4/10/87	9.503%	
Jordan #3	4/13	3,636,428.13	12/31/86	9.552%	
Israel #7	4/16	15,698,838.55	12/15/08	9.309%	
Israel #7	4/17	1,000,000.00	12/15/08	9.31%	
Indonesia #3	4/18	63,377.94	9/20/86	9.502%	
Korea #10	4/19	26,099,434.93	12/31/87	9.403%	
Korea #9	4/20	100,000.00	6/30/87	9.416%	
Jordan #2	4/24	104,940.00	11/26/85	9.532%	
Tunisia #4	4/25	82,763.16	10/1/85	9.568%	
Panama #2	4/25	6,695.50	3/31/83	9.726%	
Korea #10	4/25	2,616,507.00	12/31/87	9.473%	
Peru #3	4/26	712,929.67	4/10/84	9.631%	
Honduras #3	4/26	1,500,000.00	8/1/83	9.678%	
Ecuador #2	4/26	39,929.85	8/25/84	9.603%	
Taiwan #8	4/26	3,142.28	7/1/85	9.563%	
Thailand #2	4/30	557,380.00	6/30/83	9.837%	
Thailand #3	4/30	19,732.00	9/20/84	9.719%	
Farmers Home Administration					
	4/6	580,000,000.00	4/6/84	9.325%	9.542% annually
	4/18	325,000,000.00	4/18/84	9.415%	9.637% "
General Services Administration					
Series K-018	4/2	989,176.90	7/15/04	9.191%	
Series M-044	4/11	4,613,684.55	7/31/03	9.253%	
Series L-053	4/17	905,542.59	11/15/04	9.315%	
Series K-019	4/30	1,248,390.73	7/15/04	9.373%	
National Railroad Passenger Corp.					
Note #19	4/2	250,000,000.00	10/1/79	10.215%	
Note #18	4/11	5,000,000.00	6/29/79	10.277%	
Note #18	4/13	6,000,000.00	6/29/79	10.191%	
Note #18	4/18	6,000,000.00	6/29/79	10.01%	
Note #18	4/25	5,000,000.00	6/29/79	9.573%	
Note #18	4/30	5,000,000.00	6/29/79	10.159%	
Rural Electrification Administration					
Allegheny Electric #93	4/2	2,670,000.00	4/30/81	9.855%	9.737% quarterly
Arkansas Electric #97	4/2	2,953,000.00	12/31/13	9.216%	9.112% "
Big River Electric #58	4/2	1,879,000.00	4/2/81	9.895%	9.776% "
Big River Electric #91	4/2	764,000.00	4/2/81	9.895%	9.776% "
Wolverine Electric #100	4/2	1,409,000.00	4/2/81	9.895%	9.776% "
Northern Michigan Elect. #101	4/2	1,822,000.00	4/2/82	9.515%	9.404% "
Tri-State Gen & Trans. #89	4/3	2,548,000.00	3/31/86	9.315%	9.209% "
Associated Electric #20	4/3	300,000.00	4/3/81	9.915%	9.795% "
Associated Electric #132	4/3	10,500,000.00	4/3/81	9.915%	9.795% "
South Texas Electric #109	4/5	1,856,000.00	4/5/81	9.885%	9.766% "
M & A Electric #111	4/5	325,000.00	4/5/81	9.885%	9.766% "
Pacific Northwest Gen. #118	4/5	2,399,000.00	12/31/13	9.192%	9.089% "
Cooperative Power #130	4/6	12,000,000.00	4/6/81	9.855%	9.737% "

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
Rural Electrification Administration (continued)					
Alabama Electric #26	4/9	$ 8,600,000.00	4/9/81	9.925%	9.805% quarterly
Allegheny Electric #93	4/10	2,643,000.00	4/30/81	9.955%	9.834% "
Wolverine Electric #100	4/10	2,158,000.00	4/10/81	9.985%	9.863% "
Northern Michigan Elect. #101	4/10	2,757,000.00	4/10/82	9.595%	9.483% "
Wabash Valley Power #104	4/10	2,976,000.00	12/31/13	9.232%	9.128% "
Western Illinois Power #99	4/13	2,501,000.00	4/13/81	10.025%	9.902% "
Associated Electric #132	4/17	8,000,000.00	4/17/81	10.035%	9.912% "
Dairyland Power #36	4/18	1,022,000.00	12/31/13	9.266%	9.161% "
East Kentucky Power #73	4/19	6,949,000.00	4/19/81	9.885%	9.766% "
Big River Electric #58	4/20	3,217,000.00	4/20/81	9.855%	9.737% "
Big River Electric #91	4/20	3,232,000.00	4/20/81	9.855%	9.737% "
Gulf Telephone #50	4/20	145,000.00	12/31/13	9.254%	9.149% "
Dairyland Power #36	4/23	2,569,000.00	12/31/13	9.293%	9.187% "
Dairyland Power #54	4/23	7,431,000.00	12/31/13	9.293%	9.187% "
Chugach Electric #82	4/23	4,731,000.00	12/31/13	9.293%	9.187% "
Colorado-Ute Electric #78	4/23	414,000.00	4/23/81	9.905%	9.785% "
Sunflower Electric #63	4/23	432,000.00	3/31/86	9.395%	9.287% "
Indiana Rural Electric #107	4/25	40,000,000.00	4/25/81	9.925%	9.805% "
So. Mississippi Electric #3	4/25	508,000.00	4/27/81	9.925%	9.805% "
So. Mississippi Electric #90	4/25	650,000.00	4/27/81	9.925%	9.805% "
Cooperative Power #5	4/26	4,000,000.00	4/26/81	9.945%	9.824% "
Cooperative Power #130	4/26	8,000,000.00	4/26/81	9.945%	9.824% "
Tri-State Gen. & Trans. #89	4/30	5,690,000.00	3/31/86	9.485%	9.375% "
Southern Illinois Power #38	4/30	45,000.00	4/30/82	9.735%	9.619% "
Small Business Investment Companies					
Greater Washington Investors, Inc.	4/18	565,000.00	4/1/82	9.695%	
Suwannee Capital Corp.	4/18	1,000,000.00	4/1/84	9.465%	
Bohlen Capital Corp.	4/18	1,000,000.00	4/1/89	9.365%	
Michigan Capital & Service, Inc.	4/18	300,000.00	4/1/89	9.365%	
Van Rietschoten Capital Corp.	4/18	1,000,000.00	4/1/89	9.365%	
Student Loan Marketing Association					
Note #190	4/3	75,000,000.00	7/3/79	10.121%	
Note #191	4/10	40,000,000.00	7/10/79	10.18%	
Note #192	4/17	45,000,000.00	7/17/79	10.142%	
Note #193	4/24	70,000,000.00	7/24/79	9.610%	
Tennessee Valley Authority					
Note #96	4/13	25,000,000.00	7/31/79	10.239%	
Note #97	4/30	310,000,000.00	7/31/79	9.845%	
Department of Transportation (Section 511)					
Chicago & North Western 511-78-3	4/11	1,291,650.00	11/1/90	9.388%	
Trustee of Chicago, Rock Island	4/13	3,010,492.00	12/10/93	9.438%	9.661% annually
Trustee of The Milwaukee Road	4/25	1,317,326.00	11/15/91	9.438%	9.661% "
United States Railway Association					
Note #8	4/5	600,000.00	4/30/79	9.989%	
Note #13	4/12	500,000.00	12/26/90	8.125%	
Note #14	4/30	316,820,274.97	7/31/79	10.019%	
Note #14	4/30	42,508,148.81	7/31/79	10.019%	

FEDERAL FINANCING BANK

April 1979 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
Western Union Space Communications, Inc. (NASA)					
	4/2	$ 400,000.00	10/1/89	9.36%	9.579% annually
	4/20	8,645,000.00	10/1/89	9.387%	9.607% "
	4/24	2,760,000.00	10/1/89	9.443%	9.666% "
Department of Health, Education and Welfare					
Block #4	4/27	5,211,911.87	various	9.11%	

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

FOR RELEASE AT 4:00 P.M. May 29, 1979

TREASURY TO AUCTION TWO CASH MANAGEMENT BILLS

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills, as follows:

15-day bills (to maturity date) for approximately $5,000 million, to be issued June 4, 1979, and to mature June 19, 1979 (CUSIP No. 912793 4T 0).

16-day bills (to maturity date) to be issued June 5, 1979, representing an additional amount of bills dated December 21, 1978, and to mature June 21, 1979 (CUSIP No. 912793 Z2 5). The amount of the offering will be announced June 1.

Competitive tenders will be received at all Federal Reserve Banks and Branches, up to 1:30 p.m., Eastern Daylight Saving time, Thursday, May 31, 1979, for the 15-day bills, and up to 12:30 p.m., Eastern Daylight Saving time, Monday, June 4, 1979, for the 16-day bills.

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 each 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 of the 16-day bills 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.

B-1630

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.

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 Monday, June 4, 1979, for the 15-day bills, and on Tuesday, June 5, 1979, for the 16-day 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 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
May 16, 1979

REMARKS BY
ARNOLD NACHMANOFF
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR DEVELOPING NATIONS
BEFORE THE
AFRICAN DEVELOPMENT FUND'S SIXTH ANNUAL MEETING
ABIDJAN, IVORY COAST

Introduction

It is a great pleasure and honor for me to represent the United States at this sixth annual meeting of the African Development Fund. I wish to thank the Government of the Republic of the Ivory Coast and most especially President Houphouet Boigny for the warm hospitality which has been shown to us during the meeting in Abidjan.

The past few years have witnessed a remarkable expansion in the lending activities of the African Development Fund. In 1978, Fund lending reached a new record of almost $190 million -- compared to $47 million during the first year of Fund operations just four years ago. This achievement bears witness to the vitality and dynamism of the African Development Fund. It reflects the strong and growing confidence of member governments in the ability of the Fund to play a significant role in facilitating Africa's development and their commitment to the principle of multilateral aid.

The United States is proud of its growing role in promoting growth and prosperity in Africa through participation in the African Development Fund. Since last year's annual meeting, the United States has contributed an additional $25 million to the Fund in order to help finance its lending program for 1978. Over the next three years, the United States plans to contribute a further $125 million as our contribution to the second African Development Fund replenishment. Our support for the African Development Fund is one tangible indication of the deep commitment of the United States to the development of the nations of Africa. It also reflects our dedication to helping meet the basic human needs of the over 400 million people who live in Africa as well as a recognition of the growing cultural, economic and political ties between the United States and the African continent. Indeed, in the increasingly interdependent world in which we live, no nation can escape the consequences of economic trends and conditions in other regions of the world. All nations -- developed and developing -- have a stake in the health and vitality of the international economy.

World Economic Situation and Outlook

In looking at the world economy today, one finds conflicting trends and uncertainty which have been heightened recently by oil price increases. Aggregate demand has been sluggish in much of the industrial world outside the United States since 1973. The growth of GNP has been low by 1960's standards, making it difficult to reduce unemployment; while higher than normal inflation and larger than normal external deficits have complicated the problem by constraining governments from actively pursuing expansionary policies. One result has been that protectionist pressure groups have gained strength and sought measures which we believe would make industrial economies less dynamic and more prone to inflation.

Nevertheless, the global economy ended 1978 on an upswing. We estimate developed country growth reached 4.3 percent in the second half of the year, while growth in the developing countries continued at more than 5 percent for the third year in a row.

A major concern we now have is that recent oil price increases will hinder progress and exacerbate negative trends. Industrial country growth rates can be expected to return in 1979 to the 3.6 percent range experienced in 1978, while rising oil prices will add to inflationary pressures in both the developed and developing countries. We can also expect the pattern of current account balances as a whole to retreat from important gains. If oil prices remain at current levels, the OPEC surplus will likely swing sharply upward, while the deficit of the oil importing developing countries will increase substantially.

The U.S. Response to Africa's Needs

In Africa, recent economic developments have been mixed. While a number of countries recorded higher growth rates in 1978 than in 1977, other nations have encountered rather severe economic difficulties.

The United States is deeply committed to helping African nations overcome their difficult economic problems and has adopted policies which will foster their development:

First, we have worked to maintain a strong and stable U.S. economy as a vital prerequisite to meeting our obligation to assist the developing world and our broader responsibility to contribute to the effective functioning of the global economy. In 1978, the U.S. output of goods and services increased in real terms by four and one-half percent. On the negative side, inflation worsened during the year; consumer prices rose by nine percent -- a substantial increase from the six and three-quarter percent rise in 1977. In response to these conditions, President Carter has pursued a restrained budgetary policy, curtailing the growth of federal spending and lowering the share of America's GNP accounted for by Federal Government spending. The U.S. is also taking steps to adjust to higher oil prices and reduce U.S. energy consumption. These measures will go far to establish the fundamental conditions required for a sound dollar at home and abroad. To complement these efforts, we have also joined with other major industrial countries to coordinate closely on direct action in the foreign exchange market to prevent any resumption of the disorders which led to the precipitous decline of the dollar last fall.

Second, the Carter Administration has resisted pressures to adopt inward looking protectionist measures, and has chosen to pursue a liberal trade policy as the only path to sustained economic growth for developed and developing countries. In this regard, as part of the Tokyo Round of Multilateral Trade Negotiations the United States has agreed to a reduction of about 30 percent on some $40 billion of imports. A legislative package to implement the trade agreements reached during the Tokyo Round will go before the Congress shortly. These agreements will place greater discipline on the use of non-tariff barriers. Moreover, they will also provide a permanent legal basis for special and more favorable treatment of developing countries and liberalize the rules governing trade measures for development purposes.

Third, the United States has responded constructively to the producer need for commodity agreements, in many cases designing mechanisms to provide greater benefits from price stabilization for producer and consumer countries. These initiatives are of considerable importance to the economies of most African countries, since they affect commodities which account for a substantial share of total export earnings.

We are approaching international discussions on copper and a new cocoa agreement in a flexible fashion, aiming to design market-responsive arrangements which rely on buffer stocks to provide balanced stabilization around underlying market trends. We expect our Congress to complete ratification of the new International Sugar Agreement in the coming months, and the Administration has recently forwarded to Congress implementing legislation covering our obligations under the Coffee Agreement. Also, the United States agreed recently to a framework Agreement on Natural Rubber and is preparing for negotiations next spring on a sixth Tin Agreement. Finally, to facilitate financing of individual commodity agreements, the United States joined with other countries in agreeing on most of the basic elements of a Common Fund in March and looks forward to working out final details later this year.

Fourth, in the field of energy, the United States strongly supported a growing role for the development bank and our Overseas Private Investment Corporation in the search for energy throughout the world, as well as new bilateral cooperation programs to assist in the development of renewable energy alternatives.

-- Fifth, in order to promote food security we have worked for the establishment of a reserve stock policy designed to ensure adequate grain supplies at reasonable prices and to meet food aid commitments.

Finally, the United States recognizes that Africa will require substantial development financing in order to facilitate its development. U.S. bilateral aid to Africa totaled almost $500 million in FY 1978. The U.S. Congress has also passed legislation that will allow the poorest developing countries -- most of which are African -- to repay certain loans by spending local currencies for development projects instead of sending dollars back to the United States. The effect of this new initiative will be to increase the net flow of U.S. assistance to the poorest nations.

In addition to bilateral aid, the Administration has recently submitted to the U.S. Congress a request for the largest yearly appropriation in the history of the multilateral development banks -- $3.6 billion. This figure includes, in addition to our appropriation request of $41.7 million for the African Development Fund, almost $2.2 billion for the World Bank Group, which will also have a significant impact on Africa. In 1977 and 1978, almost one-third of IDA lending -- or $1.1 billion -- went to African countries. The International Finance Corporation (IFC) is also stepping up its efforts to assist private sector development in Africa, thereby promoting new sources of savings, investment, and employment.

More needs to be done. As we look to the future, the United States believes that it is important that we concentrate our resources on programs which most directly contribute not only to growth but also to equity in those countries which receive our aid. A major concern of my Government is that bilateral and multilateral assistance should directly help the poorest people to become productive members of their societies. In this connection, we believe that respect for fundamental human rights, including efforts to meet basic human needs, is integral to achievement of economic and social development.

We also support efforts by African countries to join together themselves to promote intra-regional cooperation and development through regional and sub-regional organizations, including, for example, the Economic Community of West African States (ECOWAS).

The African Development Fund and its Achievements

The United States joined the African Development Fund in late 1976 -- three years after the Fund's establishment. The period since our accession to the Fund Agreement has witnessed a substantial increase in our commitment to the AFDF. The most recent U.S. pledge of $125 million to the second replenishment of the African Development Fund represents approximately 17.5 percent of total resources pledged to the replenishment.

The United States is also assisting the African Development Bank Group through our bilateral technical assistance program. Since 1968, U.S.A.I.D. has funded technical services, pre-investment studies, and training to enhance the Bank's and Fund's ability to identify, appraise and monitor projects.

The African Development Fund, under the leadership of its President, Kwame D. Fordwor, has made admirable progress in increasing its ability to identify, develop and administer a portfolio of sound development projects. We would encourage Fund management, in cooperation with the Fund's Board of Directors, to continue to make improvements in the Fund's administration and operational capacity. In this task, an informed and active Board of Directors will be of vital importance. We therefore believe the well established pattern of dialogue and free flow of information between management and the Board should be fostered and strengthened in the coming years.

One area of particular interest to the United States is an intensified effort to establish independent evaluation and auditing systems within the Fund to assess the efficiency and effectiveness with which Fund loans are utilized. Development is a learning process in which the experience gained through the evaluation of earlier projects may provide invaluable insight into ways to improve future programs. We are pleased to note that Fund management has already taken certain initiatives in this area, and is establishing an internal audit unit.

We welcome the emphasis which the new Fund lending guidelines place on assisting the poor. Agricultural projects -- especially those aimed at increasing the productivity of small farmers -- may be of particular importance in the coming years given Africa's increasing food requirements.

We also wish to encourage the Fund to closely examine the technologies used in projects. Given the scarcity of capital in many African countries, it is essential for the AFDF to incorporate capital savings technologies into project designs in order to obtain the maximum development impact and benefit.

Close cooperation among international development institutions is essential if external aid is to make its maximum contribution to African development. We are pleased to note that the Fund has actively cooperated with the World Bank and other development agencies in the past and would urge the Fund to intensify its efforts at coordination and co-financing in order to assure the efficient and effective use of external development assistance.

For the past several months the U.S. administration has been engaged in an oversight process with relevant congressional committees concerning the operational procedures of the multilateral development banks. Among the subjects considered were auditing and evaluation procedures, the availability of documentation, the banks' role in aid coordination and the banks' efforts to better "reach the poor." A number of suggestions to enhance the effectiveness of the banks emerged from this review, and we look forward to discussing these ideas with both Fund management and the African Development Fund members.

Conclusion

In closing, I want to reaffirm the deep commitment of the United States to Africa and to the African Development Fund. I would also like to express our satisfaction with the historic decision by the Governors of the African Development Bank to invite non-regional nations to join their institution. The United States recognizes that non-regional membership will increase the flow of development resources to the African countries while preserving the African character of the African Development Bank. In particular, it will enhance the Bank's access to capital markets, including the U.S. capital market, the largest and most open in the world.

The U.S. administration welcomes the decision taken by the Governors, and we will consult promptly with our Congress on the legislative measures required for United States membership in the Bank. The United States looks forward to working closely with all members during the years ahead in the pursuit of our common goals.

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

FOR IMMEDIATE RELEASE
MAY 31, 1979

ADDRESS BY THE HONORABLE ANTHONY M. SOLOMON
UNDER SECRETARY OF THE TREASURY
BEFORE THE
INTER-AMERICAN DEVELOPMENT BANK
TWENTIETH ANNUAL MEETING
MONTEGO BAY, JAMAICA
MAY 29, 1979

It is a great pleasure for me to be here today to address this distinguished gathering on the occasion of the twentieth annual meeting of the Inter-American Development Bank. I would like to thank the people and government of Jamaica for the hospitality they are so graciously extending to us in beautiful Montego Bay.

The United States shares the commitment of the other members of the Inter-American Development Bank to economic development and social progress in the hemisphere. As the bank moves toward completion of two decades, we have an opportunity to reflect upon the remarkable progress that has been made toward these goals and the evolving role of the bank as the focus for regional development assistance and cooperation. The decision of the Governors last December to replenish the resources of the bank and to set new priorities for the next four years reflects the shared view that the bank should continue to expand equity in the region. The United States will maintain its firm support for the bank and its efforts to promote balanced development throughout the region.

WORLD ECONOMIC SITUATION AND OUTLOOK

The world economic situation is far from satisfactory. Inflation is at unacceptable levels in almost all countries. Many nations have near record unemployment which is increasingly of a structural nature. Severe imbalances in external payments positions continue in some countries. Moreover, the oil price and supply situation is increasing the inherent dangers which exist.

A major common problem is inflation which has risen to a dangerous point. The effects of the oil shocks of 1973/74 were clearly larger, and longer lasting, than earlier estimates suggested. And increasingly, we are beginning to pay the price for inadequate productivity and lagging capital formation, not only in the United States, but elsewhere. The evidence is provided by our present predicament: capacity constraints are being reached in a number of countries much sooner than expected, even when broad measures such as the unemployment figures tend to suggest over-all excess capacity.

Against this background the short-term outlook for inflation is a clouded one. The price hikes recently implemented by OPEC countries will hurt. Since December alone, the OPEC countries have raised prices by 27 percent. Additionally, we are beginning to see a strong upsurge in selected raw meterial prices and rising wage demands in all OECD countries. The bottom line is that we now expect inflation in the OECD area to increase by 1.5 percentage points in 1979 above the 1978 rate of 6.9 percent.

We are, however, particularly troubled by the oil price increases of last December and March and fear they will reverse recent progress and aggravate those global economic problems which have persisted. Rising oil prices will add to inflationary pressures in both the developed and developing countries despite an expected slow-down in industrial country growth rates. The global pattern of current account balances is expected to worsen significantly in 1979, reversing important recent gains. Even if oil prices do not increase further this year, the OPEC surplus will be in the $25 to $30 billion range for 1979.

The deficit of the oil-importing developing countries will increase substantially. The price increases to date in 1979 are expected to add at least $4 billion a year to the cost of their oil imports --- an unjustifiable transfer of wealth that will further hamper their development efforts. We strongly support those countries here which have recently voiced their concerns, at the unctad conference and elsewhere, about the expected adverse impact of increased oil prices on their economies.

But the outlook is not entirely gloomy. During 1979 we should continue to see slow, steady progress in a number of important areas. We expect a substantial reduction in the disparities in economic performance among OECD countries. Somewhat faster growth abroad combined with slower U.S. growth will add stability. Real growth outside the U.S. will exceed that of the U.S. for the first time since 1975.

This alteration in relative growth rates, coupled with the gains from past changes in competitive positions, will reduce external imbalances. We are already seeing this very clearly in the case of Japan and the United States, and we expect some reduction in the German surplus. The recent trade figures confirm our expectations for a substantial reduction in the U.S. deficit in 1979 continuing into 1980.

UNITED STATES POLICY AND DEVELOPING COUNTRIES' NEEDS

Over the past year we have undertaken a number of steps designed to assure a strong, non-inflationary U.S. economy. These steps are required if the United States is to do its part in the effective functioning of the world economy. They are also a prerequisite, and perhaps the most important contribution the United States can make, to improving the economic well-being of Latin America given the high degree of economic interdependence between our two regions.

The rate of real economic growth in the United States in 1978 was four and one-half percent and U.S. imports of goods and services from Latin America and the Caribbean increased 12.2 percent in 1978. In addition, three million jobs were created in the United States, and unemployment fell below six percent, but inflation clearly worsened. Consumer prices in the United States rose by nine percent for the year. Consequently, President Carter is forcefully pursuing an anti-inflationary policy through a program of monetary and fiscal restraint, supplemented by voluntary wage and price restraints and increasing competition in certain industries, such as the airlines, through federal deregulation.

We are also acting to increase energy conservation, partly through the market mechanism by decontrolling domestic oil prices, which will serve to adjust the U.S. economy to the economic realities of significantly higher world oil prices. We have also reached agreement with 19 other oil consuming nations in the International Energy Agency (IEA) to reduce oil consumption by about two million barrels per day or five percent below anticipated IEA demand.

Together these actions, in combination with the November 1st measures, have helped reestablish the fundamental conditions for a stronger U.S. dollar, which has consistently demonstrated stability in world currency markets in recent months. Furthermore, we are now coordinating closely with other major industrial countries to maintain a stable exchange market climate in which currency values reflect underlying economic and financial conditions.

The recent economic climate has given new life to internal political and economic pressures favoring the adoption of inward looking protectionist measures. Despite those pressures, President Carter has made it clear that his administration will pursue a liberal trade policy as the only path to sustained economic growth. In this regard, the trade package to conclude the Tokyo round of Multilateral Negotiations (MTN), in which the United States played a decisive role, is about to go before the Congress. That agreement will reduce U.S. tariffs on some $40 billion of imports by about 30 percent and sharply reduce non-tariff barriers, thereby assuring developing countries improved access to our market.

Along with other countries, we have taken action to strengthen the International Monetary System by the adoption of revised articles of agreement for the International Monetary Fund and Measures to countries in need of such assistance. These measures include the establishment of the supplementary financing facility, agreement on new allocations of special drawing rights during the next three years and subject to the necessary legislative approval by member Governments, a 50 percent increase in IMF quotas.

The United States views the developing nations as an integral part of the world economic system, with needs and concerns which must be taken into account in formulating all of our global economic policies, and with responsibilities which affect the functioning of the whole system. The developing countries share our interest in an open international trading and financial system, in stable international monetary arrangements, in helping to promote adequate rates of growth of global production and in improving the economic well-being of poor people everywhere.

The degree of responsibility assumed by each country should depend on its stage of development. For the poorest countries we support increased concessional development assistance and preferential treatment in international trading arrangements. We expect the more advanced developing countries to assume greater obligations through the phaseout of preferential treatment, growing participation in efforts to assist the poorer developing countries, and greater collaboration in molding the evolution of the international economic system. In return, these countries have a right to expect that their access to open markets for trade and capital, so essential to their own development, will be maintained.

These twin principles of shared responsibility and the right to participate in international economic decisions have been basic to the concrete actions taken by the United States, along with other nations, to benefit the developing countries over the past two years.

In trade, they can be seen in the MTN package in which a number of developing countries will participate directly in the new codes, yet benefit from special and differential treatment. Also improvements in the gatt framework will make it easier for the grievances of developing countries to be heard and for them to influence the evolution of the world trading system.

In commodities, approaching agreements on sugar, natural rubber and a common fund call for shared producer-consumer financing and decision-making with the objective of reducing excessive price volatility around market trends to the benefit of producing and consuming countries alike.

In development finance, where the amount of U.S. assistance has increased from $5.10 billion in FY 1976 to $7.3 billion in FY 1979, we have given increasing emphasis to the multilateral development banks, for which U.S. contributions have more than tripled over those years. 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 IDB, the oldest and largest of the regional development banks, exemplifies the cooperative, multilateral approach to effective social and economic development.

The IDB and other multilateral development banks are making great strides toward meeting the needs of poor people and poor countries. We strongly support this effort. The banks are shifting the sectoral composition of their lending activities and changing the emphasis of lending from the more traditional infrastructure projects to those which more clearly assure that the benefits of development are shared by the rural and urban poor. Thus, the IDB and the other banks are actively supporting the efforts of borrowing countries to benefit their poor.

Because of their effectiveness, their development priorities, and their contributions to worldwide economic growth, social progress and political stability, U.S. support for these institutions, which has been long and unwavering, has grown dramatically in recent years. This year the Carter Administration is requesting of the U.S. Congress appropriations for the banks of $3.6 billion.

LATIN AMERICA AND THE CARIBBEAN

Latin America and the Caribbean have, on the whole, shown great progress in the past two decades. Over that period development in the region clearly has accelerated at a rapid pace and much of Latin America, along with a small number of Asian countries, has been the vanguard of the developing world. The region has assumed an ever-increasing role in the world economy, and we expect this trend to continue.

Even in the present decade, with all its economic problems, regional GDP has expanded at an average annual rate of 5.8 percent. In contrast, the OECD countries have seen only 3.4 percent average growth over the same period.

As the region's growth proceeds, its economic importance to the United States continues to increase, with expanded opportunities for mutually beneficial interaction. U.S. merchandise exports to the region reached $22 billion in 1978, over three times the level in 1970. Similarly, U.S. merchandise imports from the region in 1978 were $24 billion, more than four times their 1970 level. U.S. direct investment in Latin America is now approximately $30 billion, about 80 percent of all U.S. Direct investment in developing countries. Lending by private banks in the United States to Latin America has also risen rapidly and exceeded $42 billion at the end of 1977 -- 21 percent of all U.S. bank lending abroad. If, as expected, the region's economies continue to demonstrate recent economic dynamism, these mutually beneficial trade and investment relationships will continue to expand at a rapid rate.

Although these economic trends are encouraging, much remains to be accomplished. Despite the overall economic progress of the region, the benefits of this progress have not flowed to all segments of the region's population or to all countries within the region uniformly. Several nations of the region remain desperately poor and, in almost all the countries of the region, there are substantial numbers of people living in poverty.

THE INTER-AMERICAN DEVELOPMENT BANK

In order for the IDB to continue its work toward the solution of a wide range of development problems, we have recently agreed to increase the bank's resources. That replenishment agreement reflects both the achievements and the needs of the region, and charts new courses for the bank over the next four years. The spirit of compromise and common purpose which prevailed throughout the negotiations resulted in an agreement which is realistic and fair to all concerned and which provides a framework for continuation of the effective contribution of the bank to development in Latin America.

In light of the economic progress of much of Latin America, the fund for special operations (FSO) will now focus more directly on those countries and people with the greatest need. Several borrowers have progressed sufficiently so that they no longer rely upon the FSO as a source of external capital. Furthermore, in view of their broader access to private capital markets and their desire to assume greater responsibility for the needs of their less fortunate neighbors, the larger and more prosperous Latin countries have agreed to increase the convertible portion of their FSO contributions and to limit their capital borrowing to approximately present levels. This will enable the poorer countries to attain substantial annual increases in their real rate of total borrowing from the bank. We strongly support this replenishment and intend to work closely with the Congress to provide our full share. Last year we were able to eliminate all previously unfunded pledges to capital of the bank. This year we have asked the Congress to authorize the full amount of our pledge in the replenishment, which is almost $3.5 billion, and to appropriate the full amount of our first year's portion for the capital and FSO as well as the remaining FSO pledge under the previous replenishment, a total in excess of $1 billion for this year alone. Congress has already held numerous hearings, and the United States Senate recently voted overwhelmingly to authorize the full amount requested. We expect the U.S. House of Representatives to complete action shortly on the authorization. The appropriations process has only recently begun and we will make every effort to secure the full amount which we have requested.

I would like to comment on several noteworthy accomplishments of the bank in the recent past:

-- Lending over the 1975-78 period confirmed closely to the goals established for that period in terms of amounts and sectoral distribution, with increasing attention to the needs of the less developed members.

-- Disbursements last year reached a new high well in excess of one billion dollars, a substantial increase over previous levels.

-- Normal mobilization of private resources through the bank's own borrowings was supplemented in 1978 by securing a record $133 million in private co-financing for high priority projects within the region.

-- The recent action to reorganize what is now known as the Office of External Review and Evaluation represents a significant step forward in the evolution of this important function, and it will bolster efforts to improve the bank's efficiency and effectiveness.

-- These accomplishments stemmed from the bank's ability to recognize and adapt to changing circumstances. The agreed goals of the replenishment, which are also based on changing circumstances, present an even greater challenge, requiring flexibility, resourcefulness, and a spirit of cooperation. We have every confidence that this institution, with the support of all its members, will meet that challenge.

One task before us is to give definition to one of the replenishment goals in order for it to become operational. Specifically, there is a need to define explicity those low income groups which will be the target of 50 percent of the bank's lending over the replenishment period and the methods and techniques which will be used to measure project benefits. We have been encouraged by the progress made thus far and believe that the establishment by the committee of the board of a date for decision on definition and methodology is a constructive step. We urge the bank to devote increased resources to this task.

The bank's mandate to intensify efforts to channel resources to projects which provide benefits to low income groups is clearly a recognition of the balance that should exist between two basic development objectives -- structural transformation and growth with equity. We recognize the difficulty of translating this general principle into operational terms. We do not envision that projects that impact exclusively and immediately on low income groups. While projects of this kind are important, careful analysis will demonstrate that a wide variety of projects can be structured to have a substantial and sustained impact on the welfare of these groups, either directly or indirectly, immediately or over the medium term.

I would also like to note that we believe that the goals and purposes of the bank encompass a broad range of fundamental concerns related to the development process, including recognition of human rights. We also believe that scarce development funds generally can best be utilized to promote economic and social objectives by governments which have manifested a commitment to protecting and promoting the rights of their people as President Carter has emphasized, we seek to cooperate with all members in finding the best ways to advance our common commitment to the protection of internationally recognized human rights including the fulfillment of basic human needs. At the same time the integrity and effectiveness of all the development banks must be assured.

For the past several months we have been engaged in an oversight process with congressional committees concerning the operational procedures of the Multilateral Development Banks must be assured.

For the past several months we have been engaged in an oversight process with congressional committees concerning the operational procedures of the Multilateral Development Banks. A number of suggestions deal among other things, with auditing and evaluation procedures the banks' role in aid coordination and the banks' efforts to reach the poor more effectively. We look forward to discussing our ideas with both bank management and the member countries.

In the view of the United States, this has been a year of major accomplishment for the IDB. The course of this institution for the next four years has been charted. It is a good one.

However, a dedicated effort will be required to fulfill the goals which have been laid out. The U.S. will strongly support the bank and we look forward eagerly to working with you and meeting the challenges of the next few years. We hope that our joint efforts will allow us to look back upon the coming period as one of great accomplishment in which the bank made notable advances toward the goal of balanced development with equity through regional cooperation.

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SHINGTON, D.C. 20220 TELEPHONE 566-2041

IMMEDIATE RELEASE
May 31, 1979

Contact: Charles Arnold
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TREASURY CLEARS REVENUE SHARING
PAYMENTS TO NEW YORK CITY

The Treasury Department and New York City today completed a "compliance agreement" removing any possibility that Federal Revenue Sharing Funds would not be received by the city as scheduled because of a court holding of discrimination in the City police department.

The agreement, signed previously by City Corporation Counsel Allen G. Schwartz, was approved today by Bernadine N. Denning, Director of the Office of Revenue Sharing.

The text of the agreement is attached.

COMPLIANCE AGREEMENT BETWEEN THE OFFICE OF REVENUE SHARING AND NEW YORK CITY

New York City (hereinafter the "City") and the Office of Revenue Sharing (hereinafter "ORS") hereby enter into a compliance agreement pursuant to the provisions of Section 122 of the State and Local Fiscal Assistance Act of 1972 as amended in 1976.

On March 12, 1979, ORS received a copy of the opinion of the United States District Court in Guardians Association of the New York City Police Department, Inc., et al., vs. Civil Service Commission of the City of New York, et al., ________ Fed. Supp. ________, 76 Civil 1982 (RLC) (Southern District, New York, February 27, 1979). That opinion held that NYC engaged in racially discriminatory employment practices in connection with the hiring of police officers on the basis of examinations given in 1968, 1969 and 1970.

ORS construes such opinion as a "holding" within the meaning of Section 122. On March 23, 1979, ORS issued a notice of the receipt of such holding and informed the City of the requirement that within a period of 30 days it would be necessary for a compliance agreement to be entered into pursuant to Section 122. The City was also apprised of its appeal rights on "funding."

No compliance occurred and on May 2, 1979, the City was notified by ORS of the suspension of funds unless within a period of 10 days the City entered into a compliance agreement or appealed the "funding" issue.

The City disputes the question of whether there has been a "holding" within the meaning of Section 122 and further contends that, if it is, a stay by a Court of the District Court's order, when entered, will suspend the effect of the Court "holding" and preclude the suspension of revenue sharing funds. The Treasury Department disagrees with such interpretation.

On May 14, the District Court entered its order in the Guardians litigation. Under that order, the City is required to perform certain steps preliminarily to establishing retroactive seniority for police officers who were the subject of the Court determined discrimination.

To resolve the differences between the City and ORS and to avoid the necessity of litigation, the parties hereby agree as follows:

1. The City has filed a notice of appeal with the Second Circuit on May 23 and upon motion will seek an expedited appeal from the Second Circuit.

2. The City will perform those actions required of it under the Court order at the time required, regardless of the fact of an appeal and regardless of whether any stay order is entered except that the provisions of paragraphs 9, 10, 12 and 14 will be stayed only to the extent that a stay order is granted by the District Court or by the Court of Appeals directed to the relief ordered in such paragraphs.

3. At each such time as the City completes an action required of it by the order of the court, a report will be made to ORS describing the action taken and providing the basis for the action taken.

4. In the event the City does not comply with the provisions of paragraph 1, the City shall, notwithstanding a stay of the District Court's order (if entered), award to class members all relief authorized by the District Court's order in a manner consistent with such order.

5. The provisions of this agreement will be modified by ORS to conform to any revised order of the District Court or of the Court of Appeals.

6. The parties agree that revenue sharing funds were employed in the Police Department. The City expressly waives further processing of its claim for administrative review of the actions of ORS.

7. This Agreement will terminate upon full compliance with the final order concluding the litigation.

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

FOR IMMEDIATE RELEASE
May 31, 1979

Contact: Alvin M. Hattal
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TREASURY FINDS CONDENSER
PAPER FROM FINLAND IS SOLD
HERE AT LESS THAN FAIR VALUE

The Treasury Department today said it has determined that condenser paper imported from Finland 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 the tentative decision issued on February 20, 1979. The weighted average margin of sales at less than fair value in this case was 18 percent, computed on all sales.

Interested persons were offered the opportunity to present oral and written views before 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 this merchandise from Finland during February-July 1978 were valued at about $528,000.

Notice of this determination will appear in the Federal Register of June 4, 1979.

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B-1634

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SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
May 31, 1979

Contact: Alvin M. Hattal
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TREASURY FINDS CONDENSER
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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 the tentative decision issued on February 20, 1979. The weighted average margin of sales at less than fair value in this case was 77.7 percent, computed on all sales.

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

(Sales at less than fair value generally occur when imported merchandise is sold in the United State for less than in the home market.)

Imports of this merchandise from France during 1978 were valued at about $2 million.

Notice of this determination will appear in the Federal Register of June 4, 1979

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B-1635

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RESULTS OF TREASURY'S 15-DAY BILL AUCTION

Tenders for $5,010 million of 15-day Treasury bills to be dated on June 4, 1979, and to mature June 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 -	99.584	9.984%	10.19%
Low -	99.579	10.104%	10.32%
Average -	99.581	10.056%	10.27%

Tenders at the low price were allotted 99%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

Location	Received	Accepted
Boston	$ 45,000,000	$ 39,950,000
New York	7,980,000,000	4,236,500,000
Philadelphia	---	---
Cleveland	---	---
Richmond	92,000,000	91,900,000
Atlanta	10,000,000	10,000,000
Chicago	553,000,000	206,950,000
St. Louis	38,000,000	37,940,000
Minneapolis	20,000,000	19,950,000
Kansas City	28,000,000	24,970,000
Dallas	---	---
San Francisco	478,000,000	342,200,000
TOTAL	$9,244,000,000	$5,010,360,000

B-1636

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TREASURY ANNOUNCES FINAL DETERMINATION
IN COUNTERVAILING DUTY INVESTIGATION ON
CERTAIN FASTENERS FROM JAPAN

The Treasury Department today announced a final determination that the Government of Japan is subsidizing exports of certain fasteners to the United States.

The Countervailing Duty Law requires the Secretary of the Treasury to collect an additional duty equal to the subsidy paid on merchandise exported to the United States.

As a result of its investigation, Treasury found that manufacturers of this merchandise received subsidies consisting of low-cost loans, deferment of repayment of loans, the right to carry back current losses related to yen appreciation up to three years to offset income and corporate and local taxes paid in prior years, and special government credit guarantees for firms affected by yen appreciation over and above those otherwise offered to small and midsize businesses.

The amount of the subsidy has been determined to be 4.2 percent ad valorem on some fasteners and 4.0 percent on the remainder.

Notice of this action will appear in the Federal Register of June 4, 1979.

Imports of this merchandise during 1978 were valued at about $315 million.

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B-1637