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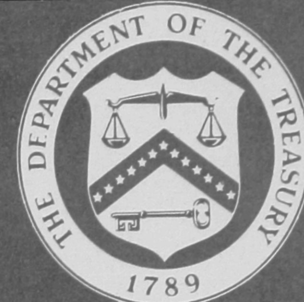

FOR IMMEDIATE RELEASE
July 2, 1979

Contact: George G. Ross
202/566-2356

TREASURY ISSUES POSITION PAPER ON NEED TO
REVISE USA/WEST GERMANY INCOME TAX TREATY

The Treasury Department today made available the text of a United States position paper on the need for a revision of the income tax convention between the United States and the Federal Republic of Germany, to take account of the West German corporate tax reform that went into effect in 1977.

The position paper was prepared in the context of ongoing income tax treaty discussions between the USA and West Germany, and was sent to tax policy officials in the German Finance Ministry. Tax policy officials in both countries have agreed to make the paper public in order to give interested parties an opportunity to comment.

Persons interested in offering comments on the attached position paper are invited to send their comments in writing to H. David Rosenbloom, International Tax Counsel, U. S. Department of the Treasury, Room 3064 Main Treasury Building, Washington, D. C. 20220.

Written comments should be received by August 17, 1979, so that they may be taken into account in preparation for the next round of discussions with West Germany, now scheduled for mid-September.

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B-1703

THE NEED TO AMEND THE INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND GERMANY BECAUSE OF THE 1977 GERMAN TAX REFORM -- THE VIEW OF THE UNITED STATES

Introduction

The Convention between the United States and Germany for the Avoidance of Double Taxation with Respect to Taxes on Income ("the Convention") was last amended in 1965. In 1977, Germany substantially modified its system of taxing corporate profits. In the view of the United States the 1977 changes in German domestic law warrant further amendment of the Convention.

In 1965, Germany taxed corporate profits under a "split-rate" system. Profits not distributed by a corporation were subject to German federal income tax at a rate of 51 percent. Distributed profits bore federal tax at a rate of 15 percent. Because of the so-called "shadow effect" - the rule that taxes on distributed profits were themselves considered undistributed profits - the effective rate of German federal corporate tax on distributed profits was in fact 23.5 percent. When the German municipal trade tax was taken into account, at the then representative figure of 12.3 percent, the effective rates of total German tax on undistributed and distributed profits were approximately 57 percent and approximately 33 percent, respectively.

The Convention as amended in 1965 provides in general for a maximum withholding tax rate of 15 percent on dividends. Prior to the 1965 amendments, the Convention dealt only with direct investment dividends, providing for a maximum 15 percent rate.

The German Tax Reform that went into effect in 1977 retained the split-rate feature of the German system but made two important changes. First, the federal corporate rate was increased, in the case of distributed profits, from 23.5 percent to 36 percent and, in the case of undistributed profits, from 51 percent to 56 percent. The shadow effect was eliminated. Taking the trade tax into account - at the current representative rate of 15 percent - the total German corporate tax burden is now 45.6 percent on distributed profits and 62.6 percent on undistributed profits.

The second important aspect of the German Reform was the introduction of an imputation credit. A German resident receiving a dividend from a German corporation increases, or "grosses up," his taxable income by the amount of federal corporate income tax paid by the corporation with respect to the distributed profits. The shareholder may then credit an amount equal to the gross-up against his individual German income tax liability. If the individual's income tax liability is less than the gross-up, he receives a refund of the difference from the German government.

The refundable imputation credit is unavailable, under German domestic law, to investors who are not German residents. It is this aspect of the German Reform, in particular, that leads the United States to seek amendment of the Convention.

Effects on United States Investors

The German Reform has had, and may be expected to continue to have, significant adverse consequences for United States investment in Germany. As a result of the Reform: (1) U.S. owned German corporations do not have important

options for capital expansion that are available to German owned German corporations; (2) U.S. shareholders are asked to bear a substantially higher German tax burden on dividends from German corporations than German resident shareholders; and (3) the German income tax is generating substantial excess foreign tax credits.

Point (3) is, of necessity, vital to the investment decisions of U.S. enterprises. As a result of the German Reform, the German tax burden on dividend income now exceeds normal international standards by a substantial measure. The 1977 Reform increased the total German corporate tax on distributed profits by 38 percent (12.6 points) and the total German corporate tax on undistributed profits by about 10 percent (5.6 points). Even a distribution of one hundred percent of a German corporation's after-tax profits (when the German tax burden is lowest) bears a German tax burden of 53.8 percent, and hence generates 7.8 points of foreign tax credits in excess of the current U.S. corporate rate. Prior to the Reform a similar distribution did not produce any excess credits.

The level of German tax might not, by itself, lead the United States to seek amendment of the Convention if that tax were applied equally to all investors in Germany. But it is clear that the German burden on U.S. investment is significantly higher than the German burden on German investment. Under Germany's imputation system the federal corporate tax on distributed profits generates a refundable credit for German resident shareholders. With respect to United States shareholders, the German corporate tax does not have this characteristic; it is simply a final tax at

the corporate level. Thus, not only is United States investment in Germany subject to substantially higher taxation as a result of the German Tax Reform, but it is subject to a burden that German investment is not required to bear.

The denial of the imputation credit to U.S. investors has important economic implications for United States investment in Germany. After the Reform, a German owned German corporation can give its shareholders the same after-tax return as prior to the Reform with a lower rate of distributions, because each unit of profits distributed is worth more to the German resident recipient (by reason of the imputation credit) than it was prior to the Reform. As a result, the German owned corporation can retain more profits for corporate expansion. The German corporation owned by U.S. residents does not have similar possibilities.

This effect of the German Reform is illustrated by the following example. Assume three German corporations -- Corporation A has only German resident individual shareholders; Corporation B is wholly owned by U.S. resident individual shareholders; Corporation C is wholly owned by a U.S. parent corporation which, in turn, is wholly owned by U.S. resident individual shareholders. In each case, it is desired to leave the ultimate shareholders with a net dividend of 200 after all taxes, out of pre-tax German corporate profits of 1000. Individuals in both Germany and the United States are assumed to be subject to an income tax rate of 36 percent on dividend income.

Corporation A declares a dividend of 200. Because of the imputation credit, there is no additional tax at the shareholder level. The German shareholder is left with a net dividend of 200. Corporation A retains 236.50.

Corporation B is wholly owned by U.S. individuals and therefore cannot rely upon the possibility of reinvestments. It must retain the funds it needs for expansion. At the same time, because Corporation B has no access to the imputation credit, it must increase its distributions to allow its shareholders to maintain a rate of return comparable to that obtained by shareholders of Corporation A. Corporation B therefore declares a dividend of 312.50. It retains 159.16.

Corporation C declares a maximum dividend of 544. If there were no German withholding tax with respect to this dividend, the U.S. parent corporation would have 540 to distribute and/or reinvest (after paying a small U.S. tax of 4). In order for the parent to leave its shareholders with an after-tax dividend of 200, it must distribute 312.50. The U.S. parent therefore would have 227.50 to reinvest in Corporation C.

Assuming a German withholding tax of 15 percent on the dividend from Corporation C, the situation is more adverse. The withholding tax liability is 81.60, and the U.S. parent must still distribute 312.50 to leave its shareholders with an after-tax dividend of 200. The U.S. parent therefore has only 149.90 to reinvest in Corporation C.

Thus, if the ultimate U.S. investors in Corporations B and C are to receive the same net dividend as the German shareholders of Corporation A, there is substantially less

available for capital expansion by Corporations B and C than is available to Corporation A, even assuming, in the case of Corporation C, that the U.S. parent reinvests all of its undistributed profits in Corporation C.

	Corp. A	Corp. B (15 percent German withholding)	Corp. C (no German withholding)	Corp. C (15 percent German withholding)
German Corporation				
Pre-tax profits	1,000.00	1,000.00	1,000.00	1,000.00
Trade tax	150.00	150.00	150.00	150.00
Federal taxable income	850.00	850.00	850.00	850.00
Dividend declared	200.00	312.50	544.00	544.00
Withholding tax	-	46.88	-	81.60
Income taxable at 36%	312.50	488.28	850.00	850.00
Tax on distributed profits	112.50	175.78	306.00	306.00
Income taxable at 56%	537.50	361.72	-	-
Tax on retained profits	301.00	202.56	-	-
Total federal corporate tax	413.50	378.34	306.00	306.00
Retained profits	236.50	159.16	-	-
German Shareholder				
Dividend received	200.00			
Gross-up for distributed profits tax	112.50			
Taxable income	312.50			
German Individual income tax liability (36%)	112.50			
Credit for distributed profits tax	112.50			
Net tax	-			
Net dividend	200.00			
U.S. Parent				
Dividend received			544.00	462.40
German withholding tax				81.60
Gross-up for German corporate level taxes			456.00	456.00
Taxable income			1,000.00	1,000.00
U.S. corporate tax liability (46%)			460.00	460.00
Foreign tax credit			456.00	537.60
Net U.S. tax (excess foreign tax credit)			4.00	(77.60)
Net income			540.00	462.40
Dividend declared			312.50	312.50
Available for reinvestment			227.50	149.90
U.S. Individual Shareholder				
Dividend received		265.62	312.50	312.50
German withholding tax		46.88		
Taxable income		312.50	312.50	312.50
U.S. individual income tax (36%)		112.50	112.50	112.50
Net dividend		200.00	200.00	200.00
Summary				
Net individual shareholder income after tax	200.00	200.00	200.00	200.00
Amount retained or reinvested in German corporation	236.50	159.16	227.50	149.90

It is true that in this example Corporation A pays a higher amount of German taxes than Corporations B or C, because amounts retained by Corporation A to finance expansion are taxed at the high rate of 56 percent. The amounts distributed by Corporations B and C benefit from the German split rate. That is not, however, the point. The point is that Corporation A can retain more profits than can be retained by Corporation B or reinvested in Corporation C, and yet Corporation A can give its shareholders the same return on investment received by the ultimate investors in Corporations B and C.

If we assume (as is realistic) that the ultimate shareholders of all three corporations seek a comparable return on their investments, there is no possibility of retaining or reinvesting in Corporations B or C, at any tax price, the amount that can be retained by Corporation A. In summary, because the German Reform increased taxes on distributed profits (and thus decreased after-tax profits), the U.S. owned German companies have fewer after-tax profits than before; and because they have no access to the imputation credit, they must distribute a larger percentage of these profits than their German owned counterpart in order to provide equivalent benefits to their shareholders.

It could be argued that the fault here is that of the United States, which does not allow imputation credits for amounts distributed by Corporation B or by the parent of Corporation C to their shareholders. There are, however, two responses to this argument. First, even if the United States did have an imputation system, it would doubtless not wish to allow full imputation credits for taxes collected by

another country. Germany does not allow such a flow-through of foreign taxes under its imputation system. Second, and more fundamentally, we must deal with the world as it is. The United States is not likely to adopt an imputation system. The hard fact remains that Germany's 1977 Tax Reform has seriously prejudiced U.S. investment in Germany, for the reasons just described.

Moreover, just as the German owned German corporation can maintain its level of distributions while retaining a greater amount for expansion, it can also keep retentions at the pre-Reform level while increasing the amount of distributions. It thus possesses another option for expansion not available to U.S. owned German corporations: increasing after-tax dividend flows with a view to attracting new share capital. If the benefits of owning shares increase, it can be expected that German residents will manifest an increased interest in investing in new share capital. Indeed, this is a primary objective of the German Reform. A German corporation that cannot pass the imputation credit on to its shareholders - for example, a German corporation owned by U.S. residents - does not have the same opportunity for capital expansion.

In short, whether a German owned German corporation distributes more or less than it did prior to the Reform, it has a power to increase corporate capital which is not available to its American owned counterparts.

The United States fully recognizes that the profits of a German corporation bear total German corporate level taxes of 62.6 percent as long as they remain in corporate solution, even when a distribution is made to a German parent corporation. This burden appears heavier than the German

burden imposed on profits distributed to an American parent by a German subsidiary: 53.8 percent in the case of a 100 percent distribution (assuming a withholding tax of 15 percent).

There are, however, two flaws in this comparison which make it meaningless when considering the issue of competitive equality. First, the comparison wholly ignores the reduction in tax when profits are distributed. Of the 62.6 points of tax in the case of the German parent corporation, 17 points ((85 x .56) - (85 x .36) = 17) represent a temporary tax imposed only as long as profits remain in corporate solution, whereas all 53.8 points of tax in the U.S. direct investment case represents a final liability. When the German parent redistributes profits received from its subsidiary to its individual shareholders, the parent's net federal corporate income tax burden of 17 with respect to those profits is, in effect, reduced to zero. A similar reduction in German tax does not apply when a U.S. parent makes a redistribution to its shareholders. A temporary tax cannot be fairly compared with a permanent tax.

Second, the comparison fails to take account of the value of 30.6 points (85 x .36 = 30.6) of German tax in the hands of the ultimate German resident shareholder. The right of a German individual shareholder to claim a credit for this portion of the tax attaches to intercorporate distributions and is not lost even if profits are redistributed through several tiers of German corporations and even if one of these corporations retains profits for many years. This compares very unfavorably with the situation of the U.S. parent corporation, which has no possibility of giving its shareholders such a credit, even if amounts received from a German subsidiary are redistributed immediately.

United States Proposal To Amend the Convention

1. Compensation for the Imputation Credit

The United States proposes that the Convention be amended to align the different tax burdens currently imposed by Germany on residents and nonresidents and to compensate for the competitive inequality created by the German Tax Reform. Of independent concern is the fact that the higher German tax rates enacted as part of the Reform create excess foreign tax credits for U.S. companies when the German withholding tax on dividends is taken into account. It is not necessary, however, to make separate adjustments to the Convention for each of these points. An appropriate adjustment for competitive and tax inequalities will also serve to bring the German tax burden closer to the available United States foreign tax credit.

The most direct, and most appropriate, adjustment would be for Germany to provide United States shareholders with benefits commensurate with the imputation credit now available only to German resident shareholders. This would mean granting United States shareholders refunds of the German federal corporate tax on distributed profits. In the case of portfolio investment, the refund should be the full 36 percent tax.

In the case of direct investment, it would be appropriate to gear the refund to the amount expected to be redistributed, on average, by the U.S. parent corporation to its shareholders. Assuming (as appears realistic) that roughly one-half of dividends received from German corporations are redistributed, the refund should be one-half of

the German federal tax burden on corporate profits. Since the split-rate feature of Germany's system already produces a benefit of 20 percentage points, a refund of an additional 8 percentage points would give relief to the extent of one-half of the German federal corporate rate of 56 percent on undistributed profits.

If Germany were to agree to make such refunds, withholding taxes could be fixed for the purpose for which they are intended: as a surrogate for net basis taxation of the nonresident shareholder. If appropriate refunds are made, the rate of reciprocal withholding taxes is negotiable, although the United States would wish to avoid excess credits.

The United States understands that Germany finds it difficult to consider making such refunds. Although we believe refunds are the fairest and most appropriate solution to the problems discussed above, we believe that another possibility exists for amending the Convention - namely, a reduction in the German withholding tax on dividends.

As a result of the German Tax Reform, individual German resident shareholders pay little if any German tax on dividends from German companies. The maximum marginal rate of German individual income tax on distributed corporate profits is 20 percent; the average is between zero and four percent. The rate of German withholding under the Convention is generally 15 percent of gross dividend income. This tax burden on nonresidents is greater than the German burden on residents, because the 15 percent rate is imposed on <u>gross</u> income, while the zero to four percent which the average German individual shareholder pays is imposed on <u>net</u> income, after personal allowances and deductible expenses.

There is, therefore, a substantially unequal German tax burden for resident and non-resident individual shareholders.

The United States believes that its shareholders should be treated fairly by the German tax authorities. It is a long-standing principle of international taxation that a withholding tax on nonresidents should function as a substitute for the tax burden imposed on residents. There is no reason to deviate from that principle here. Since the German imputation system functions, in effect, as a virtual exemption for dividend income received by resident individuals, the German withholding tax on U.S. portfolio shareholders should be reduced to zero.

It follows, moreover, the German withholding tax on direct investment dividends should also be reduced to zero. International practice normally assigns a lower withholding tax burden to such dividends than the burden on portfolio dividends. The OECD Model Convention takes this approach, as does the U.S. Model Convention. A lower tax on direct investment dividends recognizes that a withholding tax is inappropriate to the extent that funds remain in corporate solution, and that only a portion of an intercorporate distribution will be redistributed in any reasonably near term to individuals. Thus, to the extent that a withholding tax on portfolio shareholders is justifiable, a similar tax on direct investors may be justified as well (but at a reduced rate). In the case of Germany, however, there is no justification for a withholding tax on portfolio shareholders, and there can therefore be no basis for a withholding tax on direct investment dividends.

2. The Reinvestment Problem

In 1965 Germany noted that its split-rate system could create an incentive for a German subsidiary of a U.S. company to make the maximum possible distributions, even when profits were intended to be reinvested in the subsidiary. The fact that reinvested profits would bear a lower tax burden than retained profits was perceived as placing German owned German corporations at a competitive disadvantage. The 1965 amendments to the Convention addressed this reinvestment problem with a special rule: under defined circumstances, when a reinvestment was deemed to occur, Germany would be entitled to impose a withholding tax of 25 percent, rather than the normal 15 percent. This increase in German tax burden would reduce the incentive to distribute and reinvest and bring the burden on reinvested profits more nearly into line with the burden on profits retained by a German owned corporation.

In a July 12, 1978 report, a group of German companies stated that "any reduction of the German dividend tax below the [statutory] rate of 25 percent is a concession which, if the dividends are reinvested, can result in a substantial fiscal distortion of competition to the disadvantage of German investors. . . . A large number of companies therefore regard it as unjustifiable to go beyond the 15 percent rate already planned by the Federal Government. This fear would only be dispelled if the arrangement arrived at in the treaty guaranteed that no further distortion of competition could take place."

At a November 20, 1978 meeting the reinvestment problem was discussed by the Board of the Federation of German Industry ("BDI"). A translation of the summary of the BDI

presentation states that "representatives of domestic German companies are afraid that such a generous mitigation [to zero or at least 5 percent] of the withholding tax on dividends might lead to a competitive advantage for foreign companies in the German market." It was recommended that the executives of the BDI agree, among other things, that qualified minority holdings in German companies be subject to a 10 percent withholding tax burden.

In reviewing these documents it appears that some segments of German industry continue to believe that: 1) U.S. owned German companies can and regularly do distribute all profits to their parents, which can and regularly do then reinvest such profits in Germany; 2) such reinvested profits receive the benefit of the lower tax burden on distributed profits by reason of the split-rate feature of the German system; 3) this benefit creates a significant tax advantage for U.S. owned entities over domestically owned entities; 4) the cure for this reinvestment advantage lies in subjecting all distributions to a high (15 or 10 percent) withholding tax.

Under a split-rate system there can be an advantage in distributing and reinvesting profits, as compared with retaining them. And it is entirely possible that U.S. owned German corporations are presently following a policy of distributing most if not all of their profits. There is, however, no evidence to demonstrate that U.S. parent corporations are reinvesting most or all of the amounts distributed to them, and it seems doubtful that such a policy would be in the best interests of the U.S. investor. In the first place, there are indications that U.S. owned

corporations in Germany represent relatively mature investments and are not expanding substantially. In the second place, it is unrealistic to suppose that the U.S. shareholders of a U.S. controlled multinational entity would allow the corporation complete freedom to reinvest, rather than distribute, profits. Finally, as the example discussed on pages five to nine illustrates, U.S. parents of German corporations must make larger distributions than their German counterparts to meet the expectations of their investors. Compared both to the German counterpart and to the pre-Reform situation, there is less after-tax profit available for the U.S. parent to reinvest.

Thus, it is far from clear that the reinvestment advantage feared by German industry exists today in practice. Indeed, even if Germany were to reduce its withholding tax to zero, it is difficult to see the reinvestment advantage that German companies fear. Nevertheless, tax treaties are by their nature long-term commitments and must take account of future or potential problems. It is in this spirit, therefore, that we address the reinvestment question.

It appears to be true that the split-rate feature of the German system, standing alone, would provide a U.S. parent of a Germany subsidiary with a lower German tax burden on reinvested profits than the German burden on profits retained for corporate expansion by a German owned company. The appropriate solution to this question is not, however, to subject all distributions - whether or not reinvested - to a high withholding tax. This suggestion makes the withholding tax a device to rectify a possible deficiency in the corporate tax, and this is not the function of a withholding tax. Such a tax is intended to subject foreign recipients

of income to tax on a basis that is roughly comparable to the taxation of domestic recipients of such income. If domestic recipients are taxed on dividend income very modestly or not at all, it is grossly unfair and unnecessary to subject all foreign recipients to a high withholding tax merely because some profits may be reinvested by some foreign recipients.

In 1965 -- under a very different German tax system -- Germany and the United States perceived the special problem created by reinvestments, and created a special rule to deal with that problem. Even though circumstances have changed dramatically and the problem is not what it was before, the United States is prepared to work with German tax authorities in the same spirit of cooperation today. We understand that drafting may present some difficulties, but we do not believe the problems are insurmountable and in any event they do not justify penalizing parties who do not reinvest at all.

3. Adjustments to United States Withholding Taxes

The Convention presently authorizes the United States to impose a withholding tax of 15 percent on dividends to German investors, both portfolio and direct. United States taxation has changed little since the Convention was last amended in 1965. Perhaps the most significant change has been a recent reduction in the rate of corporate taxation from 48 to 46 percent.

It would appear that no adjustment is warranted with respect to the U.S. withholding rate of 15 percent insofar as German portfolio investors in the United States are

concerned. However, since the United States accepts the 5 percent rate proposed by the OECD for direct investment dividends, a reduction to this level might be acceptable.

Conclusion

It is undeniable that the German Tax Reform created advantages for capital expansion by German owned German companies. That was the intent of the Reform. The concomitant result, however, was that U.S. owned German companies were disadvantaged in comparison to their German owned counterparts. The United States believes that an appropriate amendment to the Convention rectifying this inequality is necessary.

If the United States were to accede to an amendment that did not involve refunds comparable to the imputation credits given German shareholders, the United States would in effect be deferring to the goals of the German Tax Reform. We would consider this approach, even though it would not fully restore the situation existing prior to the 1977 German Reform, if Germany were to accord a measure of compensation to U.S. shareholders for the competitive disadvantage which they suffer. A reduction in German withholding taxes would constitute such compensation.

Concern over the reinvestment issue should not be permitted to blur analysis of the point at hand. Even accepting all the assumptions on which the supposed reinvestment advantage rests, it is unfair and inappropriate to impose a higher withholding burden on all distributions because of the possibility that some reinvestment may occur. The reinvestment issue is a discrete matter, separate from the

question of the appropriate level of withholding, and a solution should be designed to deal specifically with that issue.

The matters discussed in this memorandum must be addressed and resolved at an early date. It is contrary to the common interest of our two countries to permit these contentious problems to fester. The United States is eager to work with German tax authorities to achieve mutually acceptable solutions.

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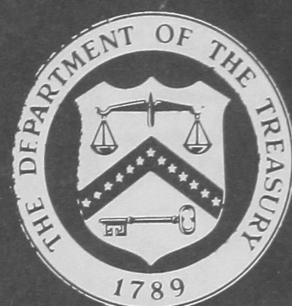

FOR IMMEDIATE RELEASE July 2, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,901 million of 13-week bills and for $3,000 million of 26-week bills, both to be issued on July 5, 1979, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 4, 1979			:	26-week bills maturing January 3, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	97.751 a/	8.897%	9.25%	:	95.526	8.850%	9.42%
Low	97.727	8.992%	9.35%	:	95.511	8.879%	9.45%
Average	97.733	8.968%	9.33%	:	95.517	8.867%	9.44%

a/ Excepting 2 tenders totaling $50,000.

Tenders at the low price for the 13-week bills were allotted 63%.
Tenders at the low price for the 26-week bills were allotted 54%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 38,845	$ 38,845	:	$ 77,305	$ 27,305
New York	3,698,340	2,306,890	:	4,506,945	2,650,345
Philadelphia	20,445	20,445	:	16,510	16,510
Cleveland	29,045	29,045	:	26,365	14,365
Richmond	22,660	22,660	:	33,790	33,790
Atlanta	33,295	33,295	:	28,540	27,030
Chicago	243,125	133,125	:	218,110	42,110
St. Louis	40,240	19,240	:	36,485	12,485
Minneapolis	16,185	16,185	:	18,255	16,415
Kansas City	26,295	26,295	:	26,440	25,440
Dallas	11,455	11,455	:	12,045	10,045
San Francisco	245,120	220,120	:	277,075	99,875
Treasury	22,900	22,900	:	24,380	24,380
TOTALS	$4,447,950	$2,900,500	:	$5,302,245	$3,000,095
Type					
Competitive	$2,792,915	$1,245,465	:	$3,811,470	$1,509,320
Noncompetitive	435,500	435,500	:	350,375	350,375
Subtotal, Public	$3,228,415	$1,680,965	:	$4,161,845	$1,859,695
Federal Reserve and Foreign Official Institutions	$1,219,535	$1,219,535	:	$1,140,400	$1,140,400
TOTALS	$4,447,950	$2,900,500	:	$5,302,245	$3,000,095

1/Equivalent coupon-issue yield.

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FOR IMMEDIATE RELEASE
July 2, 1979

Contact: Alvin M. Hattal
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TREASURY STARTS COUNTERVAILING
DUTY INVESTIGATION ON CERTAIN
VALVES AND PARTS FROM ITALY

The Treasury Department has started an investigation into whether imports of certain valves and parts thereof from Italy are being subsidized.

A preliminary determination in this case must be made by October 18, 1979, and a final determination by April 18, 1980.

Imports of this merchandise amounted to about $20.4-million in 1978.

The investigation follows receipt of a petition alleging that manufacturers and/or exporters of this merchandise receive benefits from the Government of Italy.

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 July 3, 1979.

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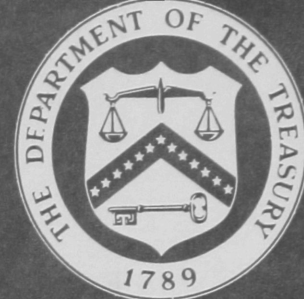

FOR RELEASE AT 12:00 NOON July 3, 1979

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $5,900 million, to be issued July 12, 1979. This offering will not provide new cash for the Treasury as the maturing bills are outstanding in the amount of $5,926 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $2,900 million, representing an additional amount of bills dated April 12, 1979, and to mature October 11, 1979 (CUSIP No. 912793 2Q 8), originally issued in the amount of $3,018 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated July 12, 1979, and to mature January 10, 1980 (CUSIP No. 912793 3L 8).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing July 12, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,384 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, July 9, 1979. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. 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. 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, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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 on July 12, 1979, in cash or other immediately available funds or in Treasury bills maturing July 12, 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
OFFICE OF REVENUE SHARING
WASHINGTON, D.C. 20226
NEWS
TELEPHONE 634-5248

CONTACT: ROBERT W. CHILDERS
(202) 634-5248

FOR IMMEDIATE RELEASE

July 9, 1979

REVENUE SHARING FUNDS DISTRIBUTED

The Department of Treasury's Office of Revenue Sharing (ORS) distributed more than $1.7 billion in general revenue sharing payments today to 37,549 State and local governments.

Current legislation authorizes the Office of Revenue Sharing to provide quarterly revenue sharing payments to State and local governments through the end of Federal fiscal year 1980.

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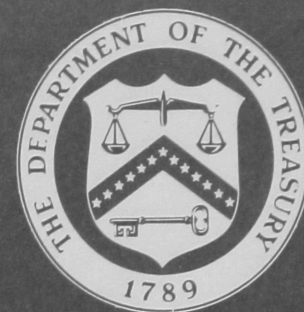

FOR IMMEDIATE RELEASE July 5, 1979

TREASURY REVISES RULES ON TAX & LOAN ACCOUNT REMITTANCES

The Department of the Treasury today announced revised procedures, effective next August 2, on remittance of tax and loan deposits to ease the burden on small depositary institutions handling $3 million or less in such funds yearly.

The action is being taken, through changes in Procedural Instructions for Treasury Tax and Loan Depositaries, to relieve a problem involving the unavailability of positive delivery systems for tax deposit information between Federal Reserve Banks and small depositaries in outlying areas.

Two revisions to the provisions affecting those Remittance Option depositaries will be:

First, for Class 2 -- the smallest Remittance Option depositaries -- an exemption will be provided, within specified limits, when calculating the amount of the analysis credits (i.e., late fees) assessable as a result of tax deposit information arriving at the Federal Reserve Bank later than the specified time deadlines.

This would be accomplished by establishing a rule which in essence states that, when the average weekly balance of funds in transit for more than one business day between the depositary and the Federal Reserve Bank is $25,000 or less, the first $5,000 will be exempt from the analysis credit (i.e., late fee) calculation.

The second revision is a change in the definition of Class 2 of the Remittance Option to include more depositaries in that class. Currently, Class 2 is defined to include depositaries which had less than $1.5 million in tax and loan credits during calendar year 1978. The revision will include in that class all Remittance Option depositaries which had tax and loan credits of $3 million or less during calendar year 1978.

These changes are expected to affect over 8,000 of the approximately 14,000 Treasury Tax and Loan Depositaries. It is further expected that as many as 91 percent of the over 8,000 depositaries either will not be subjected to late fees or will realize a partial offset of late fees.

Further details will be furnished to depositaries through the Federal Reserve Banks in their Districts.

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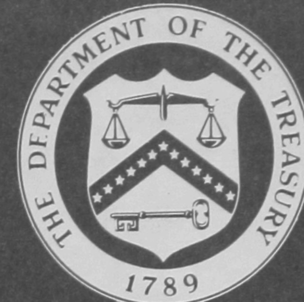

FOR IMMEDIATE RELEASE July 5, 1979

HARRY R. CLEMENTS NAMED DIRECTOR OF
BUREAU OF ENGRAVING AND PRINTING

Treasury Secretary W. Michael Blumenthal today appointed Harry R. Clements as Director of the Bureau of Engraving and Printing, effective July 15, 1979. He succeeds Seymour Berry, who retired.

The Bureau, with a work force of 3,200 in the District of Columbia, designs and produces U. S. currency, postage stamps, public debt securities, and other financial and security documents.

Mr. Clements has had a 21-year career in the aerospace and transportation systems industry involving executive responsibilities in engineering, manufacturing, new business development, administration and general management.

Before joining the Treasury Department in January 1979 as Deputy Director of BEP, Mr. Clements was chief executive officer of National Industries for the Severely Handicapped, a private, nonprofit organization that provides technical and business assistance to sheltered workshops.

Mr. Clements served as Chief of the Division of Special Industries at the Occupational Safety & Health Administration from 1972 to 1973 and as Deputy Commissioner, Rehabilitation Services Administration, at the Department of Health, Education and Welfare, from 1974 to 1975.

Mr. Clements holds Bachelor of Science and Master of Science degrees in engineering from Wichita State University and has had additional graduate-level training in business administration and government operations.

Mr. Clements and his wife, Patricia, live in Annandale, Virginia. They have six children.

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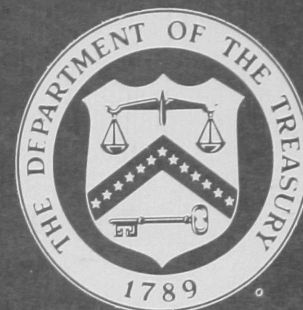

STATEMENT OF EMIL M. SUNLEY
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR TAX POLICY (TAX ANALYSIS)
ON TAX EXPENDITURES FOR HEALTH CARE
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
OF THE COMMITTEE ON WAYS AND MEANS AND THE
TAX EXPENDITURE TASK FORCE OF THE HOUSE BUDGET COMMITTEE
JULY 9, 1979

Mr. Chairman and Interested Members:

I am pleased to appear here today to discuss expenditures for health care that operate through the tax system. The President's National Health Plan offers us new ways of structuring Federal expenditures for health, and therefore, it is especially appropriate that this subcommittee and task force have undertaken a review of the tax expenditure side of Federal health policy. My testimony in part will summarize a recent Treasury research paper on this subject (attached).

Over $11 billion of Federal income tax expenditures are provided currently through the exclusion or deduction from the income tax base of payments for certain medical expenses, including premiums for insurance. These tax expenditures are the principal programs of government assistance for the purchase of medical care by the non-aged, non-poor population.

Specifically, the tax system subsidizes the purchase of medical care by means of provisions permitting (1) employer contributions for health insurance premiums or other medical payments for employees to be excluded from taxable income and (2) certain medical expenses to be deducted from adjusted gross income on individual income tax returns.

The tax expenditure estimate of $11 billion relates to the Federal income tax alone. There is a further tax expenditure cost of about $2 billion to States with income taxes. In addition, social security tax revenues are reduced by about another $4 billion. In total, Federal and State revenues are reduced by about $17 billion because certain health expenditures are allowed to be excluded or deducted from income and social security tax bases.

Like many tax expenditures, I am not sure that Congress, if starting over, would determine that existing tax expenditures for health care would be an optimal way of providing either tax relief or assistance for purchasing medical care. Current tax law in this area has resulted more from a maintenance of past practice, or habit, than from a process in which choices were made among means of subsidizing expenditures for health care.

The Medical Deduction

No deduction for medical expenses existed until 1942. During World War II, substantial numbers of citizens were brought under the income tax and tax burdens were raised significantly; it was felt that some relief from this heavier tax burden should be granted to taxpayers with extraordinary medical expenses. Consequently, deductions were allowed for certain medical expenses exceeding a five percent floor. The 1951 Act and subsequent provisions effectively eliminated any floor for medical expenses for the aged; in 1965, however, the Social Security Amendments required that all taxpayers, including the aged, again to be subject to the same floor.

In 1954, another major change was made when the five percent floor was lowered to three percent, and an additional one percent floor was applied to expenses for drugs before those expenses could be counted toward the overall three percent floor. A major justification for both actions was that deductions should be allowed for all "extraordinary" expenses. While a five percent floor was considered too high to cover all extraordinary expenses, a one percent floor was considered necessary to exclude ordinary drug expenses.

Besides the one percent floor on drugs, another separate calculation was required when the Social Security Amendments of 1965 allowed a deduction for one-half the cost of medical

insurance, up to a maximum deduction of $150, without regard to the 3 percent floor. The remaining half of insurance premiums (including premiums in excess of $300) are subject to the 3 percent floor.

The deduction for medical expenses generally has been justified on the grounds that extraordinary medical expenses reduce ability to pay taxes and that the income tax base should take account of this. However, this argument makes more sense for uncontrollable than it does for controllable or voluntary medical expenses, and also, there is no clear standard for what constitutes extraordinary expenses. Moreover, only 23 percent of taxpayers benefit from the medical deduction and 41 percent of these only deduct one-half of their insurance premiums.

Distributionally, the value of the itemized deduction rises with income. Of course, the deduction is of no value to the non-itemizer. However, even among returns with itemized medical deductions, the average tax expenditure per return increases as income increases. This increase is the result of several factors, including higher marginal tax rates and greater medical expenditures at higher income levels. The 3 percent floor does result in a decline in the proportion of taxpayers who can itemize expenses in excess of the floor, especially at income levels in excess of $50,000. However, if the average tax expenditure is calculated across all taxpayers in the income class, rather than just itemizers, the tax expenditure is still of greater average value to taxpayers in higher income classes, rising from $10 for taxpayers with incomes between $5,000 and $10,000 to $501 for taxpayers with incomes of $200,000 or more.

Recent Administration proposals. In 1978 the Carter Administration proposed that medical and casualty losses be deductible only to the extent that, when combined, they exceeded ten percent of adjusted gross income. All medical expenses, including health insurance premiums and drug expenses would be subject to this same floor. Thus there would be no separate allowance for half of insurance premiums nor would there be a separate one percent floor for drugs. The House of Representatives accepted the simplification aspects of this proposal, but the suggested ten percent floor was kept at three percent, and casualty losses were not folded into the medical deduction. The Senate rejected the House provision and no change was made in the Revenue Act of 1978.

Nonetheless, if the itemized deduction is to apply only to extraordinary expenses, then the floor should be raised. While the floor for itemized medical expenditures has remained at three percent for 25 years, the proportion of income spent on medical expenditures has risen. From 1950 to 1976, total health expenditures, both public and private have risen from 5.9 percent to 12.6 percent of adjusted gross income, while private expenditures have risen from 4.5 percent to around 7 percent. What at one time may have been an extraordinary level of medical expenditures may now be only an ordinary or normal level. Substantial simplification would also be possible if fewer taxpayers were required to maintain medical records.

As part of its National Health Plan, the Administration has again proposed that medical expenses be deductible only to the extent that they exceed ten percent of adjusted gross income. Although we believe that the floor should be raised even in absence of a National Health Plan, there are additional, compelling reasons why the deduction should be limited in the context of a National Health Plan. Perhaps most importantly, unlike 1978, today a clear choice is given to redirect some of the current Federal expenditures on health care rather than merely reduce those expenditures. Moreover, a National Health Plan means that total Federal expenditures for health would increase substantially, leading to subsidies not only of the aged and disabled, but also of those persons in high risk categories and those currently unable to obtain insurance. Indirect subsidies to individuals may also result from subsidies of premium payments made by employers. There is no reason why we should want to run a separate subsidy system by allowing deductions for non-extraordinary medical expenses.

Exclusion of Employer Paid Premiums for Medical Insurance

Historically, the exclusion from individual income taxation of payments to employer-provided group plans has existed since the adoption of the income tax; only the rationale for the exclusion has varied over time. At first, most fringe benefits of employees were not taxed -- tax rates were low and non-cash compensation was not widely recognized as income. Of course, before World War II, the income tax did not affect the majority of workers, and taxation of fringe benefits would have served little purpose in the case

of non-taxable workers. Moreover, a few decades ago, benefit payments under group health insurance were much smaller relative to income. Later Internal Revenue Service rulings eventually supported the exclusion, and in 1954 the exclusion was written into the Code. However, despite later recognition that fringe benefits indeed are income, and despite rapid growth in amounts spent on group health insurance, no substantial changes have ever been made in the exclusion. Treasury figures show the Federal income tax expenditure cost of the exclusion to have grown from $1.1 billion in 1968 to $8.3 billion in 1979.

The distribution of benefits from the exclusion is somewhat similar to the deduction; that is, because marginal tax rates increase with income, a dollar of tax-free health insurance is worth more (i.e., the tax expenditure cost is greater) to taxpayers at higher income levels. However, the exclusion is available to all employees, regardless of whether they itemize on their returns. Below tax-exempt levels of income, of course, there is no employee gain from either the exclusion or the deduction. The exclusion can also be viewed as a subsidy for the purchase of medical insurance through an employer, with the subsidy rate increasing with income.

Recent Administration Proposals. In 1978, the President proposed that employer-sponsored medical, disability and group-term life-insurance plans be required to provide nondiscriminatory benefits to a fair cross-section of employees, not merely to a select group of officers or highly compensated employees. Anti-discrimination tests would have been similar to those applied with respect to coverage and benefits under qualified retirement and group legal plans. Congress, however, adopted substantial nondiscrimination tests only for coverage and benefits under medical reimbursement plans which are not funded by insurance, thus allowing discrimination with respect to insured medical plans (as well as disability benefits and group-term life insurance).

As part of the National Health Plan, the President has proposed that employers make equal dollar contributions to all plans that they offer, thus encouraging employees to seek out lower cost plans so that the employer's relative contribution will be greater. We believe that this proposal will not only solve some of the problems of discrimination,

but also will increase competition in the medical marketplace by giving employees an incentive to choose among cost-efficient plans or health maintenance organizations.

Effect of Tax Expenditures For Health on The Demand and Price of Medical Care

I believe that this subcommittee and task force are especially interested in the effect of the tax expenditures for health on the demand and price of medical care.

Exclusions for medical care, like many other tax expenditures, are mostly open-ended. That is, there are few, if any, budget limits on the amount of the expenditure that can occur. In the area of fringe benefits, earners have a substantial and fairly open-ended incentive to convert wage compensation into nontaxable compensation in order to minimize their taxes. For instance, for a taxpayer with a 20 percent marginal tax rate from all sources, $1 in cash compensation can buy no more than $0.80 in nontaxable compensation. The tax incentive lowers the price of the fringe benefit and thereby creates a powerful demand for more of the fringe benefit-- far beyond the demand that would exist in absence of the incentive.

Over the last three decades, these demands have increased enormously, and non-cash compensation has become a large part of the compensation package of most workers. As a result, the income tax base has been eroded. To compensate for this, the rate of tax on cash wages effectively must be increased if a given amount of revenue is to be raised; thus, marginal rates of tax on cash wages must go up even if average rates of tax on all compensation remain steady. Workers who receive larger proportions of their compensation in cash -- often workers in weak firms or secondary workers -- suffer the most from this shift in tax liabilities. Also, the social security tax base has been eroded, slowly forcing other changes in that system of taxation. Moreover, some inflationary pressures can be traced in part to demands of employees for greater increases in payments to nontaxable benefit plans than for increases in cash compensation. It should also be noted that policies to grant equal pay to employees of both sexes are often hindered by the inability of the secondary worker to receive equal value of pay in fringe benefits.

These problems are present with all exclusions of fringe benefits from income subject to tax. The exclusions increase the demand for fringe benefits, which in turn weaken the effort of policies which are based on cash compensation.

In the case of health benefits, income in the form of employer-paid health insurance premiums is exempted from Federal income tax, State income tax and social security tax. Thus, employees are inclined to accept a larger share of their compensation in the form of health insurance than they would if the income in-kind was taxable. This has contributed to the growth in employer payments to group health plans from 0.8 percent of wages and salaries in 1955 to 2.8 percent in 1975.

Since the exclusion provision reduces the price employees must pay for health insurance, it is also likely to increase the demand for coverage under health insurance. Increased coverage in turn increases the demand for health care. Improved coverage may be reflected in a reduction of the deductible amount, a reduction of the coinsurance or copayment amount, or inclusion of previously uncovered services. Since tax rates are higher in higher income brackets, the price reduction--and the price incentive to increase the quantity of services demanded--increases with income.

The effect of allowing itemized deductions for health care expenses may be analyzed along the same lines. The deduction for health insurance premiums has much the same effect as the exclusion: it reduces the after-tax price of health insurance or health care, and the reduction is of greater value at higher income levels. The major difference is that the exclusion is available regardless of whether the taxpayer itemizes deductions or takes the standard deduction, whereas the personal deduction for health insurance premiums must be itemized. For the majority of taxpayers who do not itemize, there is no price reduction.

The requirement that medical expenses exceed three percent of AGI before qualifying as a deduction (except for 50 percent of health insurance premiums up to $150) is somewhat similar to a deductible clause in an insurance policy. According to some researchers, a small deductible has little effect on the demand for hospitalization, while, for ambulatory and other non-hospital services, a moderate size deductible is likely to influence demand markedly.

While the three percent floor is roughly analogous to a deductible in an insurance policy, the exclusion of employer premiums and the deduction of all expenses above three percent are both analogous to a copayment rate. For employees in group health plans and for itemizers above the 3 percent floor, then, the marginal tax rate determines the proportion of the last dollar of medical expense or medical insurance paid by the government; thus, the copayment rate equals one minus the taxpayer's marginal tax rate. Again, the tax incentive for increased use of medical srvices is greater the higher the taxpayer's taxable income.

The exact effect of these tax subsidies on the overall demand for health services is thus based in large part upon the subsidy rate on marginal expenditures. On average the Federal income tax expenditures of about $11 billion cover approximately 9 perent of total private expenditures for health care. At the margin, however, the reduction in price is much greater than 9 percent. The marginal price reduction is equal to the taxpayer's marginal tax rate. For an average employee, the income tax rate alone is 22 percent. If we also take into account State income taxes and social security taxes, that marginal rate rises to about 35 percent. For the average itemizer, the marginal rate of income tax is about 25 percent; adding State income taxes raises the rate to about 29 percent. Since demand is based primarily upon marginal price, the impact of the tax expenditures upon the demand of medical services is greater than the price reduction averaged across all expenditures would indicate.

Whether increased demand for medical services will actually lead to an increase in the quantity purchased will depend primarily upon demand and supply. In general, the more responsive supply or demand is to price changes, the more likely will the tax subsidy increase the amount of medical care provided in the economy. While the demand for health care is often viewed to be insensitive to price, price effects on demand may be much stronger for controllable expenses or non-catastrophic events than for uncontrollable or catastrophic occurrances. That is, demand for some minimal health care or insurance may not be responsive to price, but the demand for additional health care or insurance may be much more responsive.

Insurance complicates considerably the demand side of the medical marketplace. Some researchers argue that the demand for health insurance is relatively responsive to price incentives (compared to most estimates of the demand for medical care). Tax subsidies then lead to increased insurance coverage, and increased coverage, in turn, leads to lower copayment rates on medical goods actually purchased. These researchers then suggest that, once a large proportion of the population pays little or nothing for additional medical services, the demand side of the market ceases to exert an independent restraint on the market, and medical care price changes, over time, are determined by non-market forces or events.

Because tax subsidies act to increase the demand for medical care, they also tend to increase its market price. A subsidy creates a wedge between the market price received by the seller and the net cost to the buyer. Increases in price result in the tax subsidy (or the wedge) being shared with the providers of medical care; thus, the greater the increase in market price, the less the tax subsidy reduces the net cost of medical care to taxpayers.

To make matters worse, market price increases probably apply fairly uniformly to many types of purchase of medical care, while the value of the tax subsidy increases with the taxpayer's income. Thus, even if the tax subsidy results in a net price (after subsidy) decrease to the average taxpayer, it may still result in a net price increase for low- and moderate- income taxpayers who receive only a small price subsidy. For those who do not receive any subsidy, a net price increase is almost certain.

There are various ways in which the exclusion and deduction can be redesigned or replaced so as to change the method of subsidy and to limit their effects on the demand for health insurance and health care. Some of these would involve placing a cap on the amount of the exclusion, such as proposed by Congressman Ullman, or requiring qualified group health plans to adopt certain standards with regard to minimum copayment rates, such as proposed by Congressman Jones. The President has proposed to increase the floor on the medical deduction, to replace some tax expenditures with direct subsidy programs, and to require employers to make equal contributions to all plans that they offer. Of course,

any program which changes the amount of expenditures made by employees or private persons will affect the size of the tax expenditure, even with no change in the Tax Code.

Summary

In summary, tax expenditures for medical care form a large and growing part of the Federal budget. For 1979 Federal income tax expenditures for medical care will exceed $11 billion and will comprise about 5 percent of total expenditures for medical care and about 9 percent of private expenditures. State income tax and social security tax collections are also reduced by another $6 billion. While not as large as direct expenditure programs such as Medicare and Medicaid, these tax expenditures do have an impact upon the demand and price of medical care. At the margin, these expenditures often reduce price by 29 to 35 percent.

Practically all policies connected with medical care affect the amount of tax expenditures for medical care. Direct expenditures may change tax expenditures even if the laws affecting the exclusion and deduction are unchanged. The design and choice of tax expenditure policy should be dependent upon the extent to which tax burdens are to be shared between those receiving cash compensation and those receiving compensation in other forms, the extent to which medical exclusion, deductions and subsidies are to be made equally available to all persons, the design of direct expenditure programs, and the limits that should be placed on tax-induced increases in demand for health insurance and health care.

OTA Papers

Tax Expenditures
for Health Care

Eugene Steuerle
Ronald Hoffman
U.S. Treasury Department

OTA Paper 38 April 1979

Department
of the
Treasury

Assistant Secretary for Tax Policy
Office of Tax Analysis

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TAX EXPENDITURES FOR HEALTH CARE

I. INTRODUCTION

Because of the renewed interest in proposals to provide for National Health Insurance, and because of increased concern over the rising cost of medical care to both individuals and the government, much recent research has focused on equity and efficiency aspects of direct expenditure programs to provide medical care. Yet the Federal Government also helps individuals finance the purchase of medical care through substantial tax subsidies. Over $11 billion of Federal income tax expenditures are provided currently through the exclusion or deduction from the income tax base of payments for certain medical expenses, including premiums for insurance. 1/ These tax expenditures are the principal programs of government assistance for the purchase of medical care by the non-aged, non-poor population.

1/ This paper does not treat other indirect tax subsidies such as deductions for charitable contributions to health or medical institutions, tax exemption of interest on hospital bonds, expensing of removal of architectural and transportation barriers to the handicapped, and the non-taxability of social security and public assistance payments for medical care.

Specifically, the tax system subsidizes the purchase of medical care by means of provisions permitting (1) employer contributions for health insurance premiums or other medical payments for employees to be excluded from taxable income; 2/ and (2) certain medical expenses to be deducted from adjusted gross income on individual income tax returns. In general, payments by employers for medical insurance or other medical care of employees are deducted as a cost of business; at the same time, these payments are excludable from the gross income of employees. In addition, individuals are allowed itemized deductions for 50 percent of the amount paid for health insurance premiums, up to a maximum of $150, and for other medical care expenses (including the remaining amount of health insurance premiums) which exceed three percent of the taxpayer's adjusted gross income (AGI). Expenditures for drugs and medicines may be counted in this three percent floor only to the extent that they separately exceed one percent of AGI.

This paper will examine these tax expenditures, their impact on the Federal budget and their effects on price and demand for medical care. Section II provides a brief history

2/ In this paper, the terms "exclusion" or "employee exclusion" will be used as an abbreviated reference to the exclusion from taxation by employees of employer contributions to health plans.

of tax law changes leading to the present exclusion and deduction. Section III presents estimates of revenue loss from these tax expenditures and some evidence on their increasing cost over time. Section IV then analyzes the distributional impact of these expenditures. Effects of the taxation of medical expenditures on the demand and price of medical care are discussed in Section V, while some policy alternatives are detailed in Section VI. Finally, a summary is contained in Section VII.

II. HISTORY OF MEDICAL EXCLUSIONS AND DEDUCTIONS

Although the exclusion from individual income taxation of payments to employer-provided group plans has existed effectively since the adoption of the income tax, the rationale for that exemption has varied over time. At first, most fringe benefits of employees were not taxed -- non-cash compensation was not widely recognized as income. Of course, before World War II, the income tax did not affect the majority of workers, and assignment of value of fringe benefits would have served little purpose in the case of non-taxable workers. Moreover, a few decades ago, benefit payments under group health insurance were much smaller relative to income, both because a smaller proportion of income was spent on medical care and because more private payments were made by individuals or through individual, rather than group, policies. Internal Revenue Service rulings 3/ eventually supported the exclusion by declaring that the premiums paid by an employer to a group insurance medical policy were not taxable to the employee.

In later years, however, it came be to recognized that in-kind compensation was a form of wages which could be

3/ Special Ruling, October 26, 1943, 433CCH, Federal Tax Service par. 6587.

subject to tax. By 1953, IRS rulings had become somewhat inconsistent. While employer payments on group policies remained nontaxable to employees, employer-paid premiums on individual policies were deemed to be income subject to tax. 4/ In the 1954 Code, Congress decided to make the exclusion uniform, and all contributions to accident or health insurance plans have since been allowed an exclusion from income by the employee.

The tax treatment of medical expenses paid by individuals (rather than by employers) has evolved differently. No deduction for medical expenses existed until 1942. During World War II, substantial numbers of citizens were brought under the income tax and tax burdens were raised significantly; it was felt that some relief from this heavier tax burden should be granted to taxpayers with extraordinary medical expenses. Consequently, deductions were allowed for medical expenses exceeding five percent of net income, with a maximum deduction of $2,500 for families. The maximum deduction was raised several times and finally eliminated in 1965.

Changes were also made in the five percent floor. The 1951 Act and subsequent provisions effectively eliminated any floor for the medical expenses of the aged or for taxpayers

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4/ Rev. Rul. 210, CB 1953-2, p. 114

taking care of aged dependent parents. However, in 1965 the Social Security Amendments provided substantial amounts of medical care for the aged and at the same time required all taxpayers, including the aged, again to be subject to the same floor for itemized medical deductions. 5/

In 1954, another major change was made when the five percent floor (by now based on adjusted gross income) was lowered to three percent, and an additional one percent floor was applied to expenses for drugs before those expenses could be counted toward the overall three percent floor. A major justification for both actions was that deductions should be allowed for all "extraordinary" expenses. While a five percent floor was considered too high to cover all extraordinary expenses, a one percent floor was considered necessary to exclude ordinary drug expenses.

Besides the one percent floor on drugs, another separate calculation was required when the Social Security Amendments of 1965 allowed a deduction for part of the expenses of insurance policies without regard to the overall floor. 6/

5/ The change was made effective beginning in 1967.

6/ A deduction was allowed for one-half of insurance premiums, not to exceed $150. Any remaining insurance premiums were to be subject to the three percent floor.

The rationale for this allowance was that the normal deduction favored those who could self-insure against variable expenses, while those who stabilized their outlays through purchase of insurance would be less likely to benefit from the deduction.

In 1978, the Carter Administration proposed that medical and casualty losses be deductible only to the extent that, when combined, they exceeded ten percent of adjusted gross income. All medical expenses, including health insurance premiums and drug expenses would be subject to this same floor. Thus there would be no separate allowance for half of insurance premiums nor would there be a separate one percent floor for drugs. The House of Representatives accepted the simplification aspects of this proposal, but the suggested ten percent floor was kept at three percent, and casualty losses were not folded into the medical deduction. The Senate rejected the House provision and no change was made in the final Act. 7/

While the floor for itemized medical expenditures has declined to three percent and remained there for over two decades, the proportion of income spent on medical

7/ The Revenue Act of 1978.

expenditures has risen. Table 1 shows health expenditures from 1950 to 1976 and compares this data to adjusted gross income of households. During this period, total health expenditures, both public and private, 8/ have risen from 5.9 percent to 12.6 percent of adjusted gross income, 9/ while private expenditures have risen from 4.5 percent to around 7 percent. What at one time may have been an extraordinary expenditure may now be only ordinary. In fact, this increase in percent of income spent on health expenditures was a major argument for the Carter Administration's proposal to increase the floor on combined medical and casualty deductions to ten percent. Other arguments related to the small percentage (about 25 percent) of taxpayers benefitting from the medical deduction, and to the simplification possible if fewer taxpayers were required to maintain medical records. Opponents of the change, on the other hand, argued that it would be unfair to raise the floor at a time when medical expenses were becoming more burdensome. Apparently, Congress, in maintaining the three percent floor, has shifted

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8/ For estimates of total public and private health expenditures, see Gibson and Fisher (1978).

9/ As a percent of GNP, health expenditures are about nine percent.

Table 1

Year	Health Expenditures 1/		Adjusted Gross Income (AGI) 2/	Health Expenditures as a Percentage of AGI	
	Total Public and Private	Private		Total Public and Private	Private
	(.........$ billions ....)				
1950	12.0	9.0	202.1	5.9	4.5
1955	17.3	12.9	273.9	6.3	4.7
1960	25.9	19.5	346.1	7.5	5.6
1965	38.9	29.4	466.4	8.3	6.3
1966	42.1	31.3	508.9	8.3	6.2
1967	47.9	32.0	541.6	8.8	5.9
1968	53.8	33.7	595.6	9.0	5.7
1969	60.6	37.7	644.7	9.4	5.8
1970	69.2	43.8	677.3	10.2	6.5
1971	77.2	48.4	719.9	10.7	6.7
1972	86.7	53.2	793.2	10.9	6.7
1973	95.4	58.7	887.5	10.7	6.6
1974	106.3	64.8	963.1	11.0	6.7
1975	123.7	71.3	1,008.3	12.3	7.1
1976	141.0	80.8	1,118.7	12.6	7.2

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1/ Health expenditure estimates are for fiscal years. Source: Gibson and Fisher (1978).

2/ Source: U.S. Department of Commerce, Bureau of Economic Analysis.

from a standard which allowed deductions for "extraordinary" expenditures to one in which deductions are allowed for expenses which are more than a "moderate" proportion of income. This shift makes the personal deduction more consistent with the employer exclusion in which all payments for medical expenses or insurance are non-taxable to the employee.

III. REVENUE COST OF TAX EXPENDITURES FOR HEALTH: 1968 - 1979

For fiscal 1979, Federal income tax expenditures for health care will be over $11 billion. Seventy-four percent of this total is for the employee exclusion of employer contributions, while 26 percent is for individual deductions. These tax expenditures cover about 5 percent of total public and private health care expenditures and about 9 percent of private expenditures. Like Medicare and Medicaid, these subsidies are non-taxable and are of even more value to individuals than an equivalent increase in before-tax income.

The tax expenditure estimate of $11 billion relates to the Federal income tax alone. There is a further tax expenditure cost of about $2 billion to States with income taxes. In addition, social security tax revenues are reduced by about another $4 billion, although this revenue reduction does not properly constitute a tax expenditure. 10/ In total, Federal and State revenues are reduced by about $17 billion because of these tax expenditures.

10/ Since social security operates at least in part as an insurance scheme, the reduced taxes are reflected in reduced benefit payments later.

Most workers currently benefit from the exclusion of employer payments. According to the latest data from the Social Security Administration (Yohalem, 1975), in 1975 about 58.2 million workers or 72 percent of all wage and salary workers, were covered by some type of health care insurance financed by employer-paid premiums.

Treasury estimates show the Federal income tax expenditure cost of this exclusion to have grown from $1.1 billion in 1968 to $8.3 billion in 1979, or at a rate of about 20 percent a year. (See Table 2). While changes in the Treasury method of estimation do not allow exact comparisons, there clearly was a sharp rise in lost revenue during these years. This rise can be traced primarily to two factors: (1) the increase in cost of medical insurance, and (2) the growth in use of nontaxable fringe benefits as a means of payment for work. The increased use of insurance may itself have led to increased costs of medical care, in turn raising the cost of medical insurance. And, although there may have been increased use of group insurance policies in absence of the exclusion, there is little doubt that the exclusion acts as an incentive for workers and employers to receive their compensation in non-taxable health benefits rather than taxable wages. Since the government pays part of the cost through reduced tax collections, the employee faces

a lower after-tax price for his health insurance. The employer may also share in this benefit since he can provide an increase in after-tax compensation more cheaply through extra insurance than through direct wages.

Compared to the exclusion, fewer taxpayers benefit from the itemized deduction of medical expenses on individual income tax returns. Still, by 1978, 20 million tax returns are estimated to have claimed itemized deductions of $14.4 billion for medical care expenses. The estimated revenue cost of this tax expenditure has grown from about $1.5 billion in 1968 to $2.9 billion in 1979 or at a rate of about 7 percent per year. This lower growth rate for the deduction -- as compared to the exclusion -- can be traced to two principal factors (besides changes in methods of estimation). First, the increased use of employer-provided insurance over these years has meant that a lower proportion of total medical expenditures were being paid out-of-pocket. Second, the size of the standard deduction (currently called the "zero bracket amount") has increased greatly during this period. For instance, for joint returns before 1970, the minimum amount of the standard deduction was $200, plus $100 for each exemption 11/ (other than age and blindness). By

11/ Or, for certain taxpayers, the deduction equaled 10 percent of adjusted gross income, if greater.

1979, the minimum amount (and the maximum amount) of zero bracket amount (standard deduction) for joint returns had risen to $3,400, regardless of income, and the number of taxpayers itemizing deductions had fallen correspondingly.

Table 2

Major * Federal Income Tax Expenditures for Health Care
($ millions)

Fiscal Year	Exclusion of Employer Contributions for Medical Insurance Premiums and Medical Care	Deductibility of Medical Expenses on Individual Income Tax Returns	Total
1979	8,255	2,890	11,145
1978	7,105	2,785	9,890
1977	5,560	2,556	8,116
1976	4,490	2,315	6,805
1975	3,275	2,315	5,590
1974	2,940	2,125	5,065
1973	2,500	1,900	4,400
1972	2,000	1,900	3,900
1971	1,450	1,700	3,150
1970	1,450	1,700	3,150
1969	1,400	1,600	3,000
1968	1,100	1,500	2,600
Average Annual Growth Rate	(20 %)	(7 %)	(13 %)

*/ Excludes deductibility of charitable contributions (health), tax exemption of interest on hospital bonds, expensing of removal of architectural and transportation barriers to the handicapped, and non-taxability of social security and public assistance payments for medical care.

IV DISTRIBUTION OF TAX EXPENDITURES BY INCOME CLASS

Table 3 shows the latest Treasury estimates of the distribution among income classes of tax expenditures from the exclusion of employer payments for health care. The numbers are highly tentative and are based upon some simple assumptions about the distribution of employer-provided health insurance among employees. Because marginal tax rates are higher in higher income classes, a dollar of tax-free health insurance is worth more (i.e., the tax expenditure cost is greater) to taxpayers at higher income levels. Below tax-exempt levels of income, of course, there is no employee gain from the tax expenditure.

Table 3

Distribution of Tax Expenditure for Employer
Payments for Health Care
Fiscal Year 1977

Expaned Income Class ($000)	Tax Expenditure ($ millions)
0 - 5	$ 91
5 - 10	494
10 - 15	814
15 - 20	1,028
20 - 30	1,547
30 - 50	882
50 - 100	456
100 - 200	178
200 and over	70
TOTAL	$ 5,560

Source: U.S. Treasury Department. Information is contained in a news release from Senator Muskie's Office, "Muskie News" (February, 1978), Appendix, p. 4.

By using a 50,000 sample of individual tax returns and the Treasury Tax Model, the distribution of tax expenditure benefits can be determined with more detail and accuracy for itemized deductions. Table 4 demonstrates that the average tax expenditure per return with itemized medical deductions increases as income increases (column 9). This increase is the result of several factors, including higher marginal tax rates and greater medical expenditures at higher income levels. Moreover, if the average tax expenditure is calculated across all taxpayers in the income class, rather than just itemizers, the tax expenditure is still of greater expected value in higher income classes (column 6).

It is somewhat surprising that the regressiveness of the deduction is not tempered more by the 3 percent floor which applies to most itemized medical expenses. A percentage floor decreases the probability that a high income person can itemize medical expenses in excess of the floor. For instance, a person with $20,000 of adjusted gross income can itemize expenses (subject to the floor) in excess of $600, while a person with $100,000 of adjusted gross income can itemize expenses only in excess of $3,000. However, while increases in income do reduce the probability of itemizing deductions in excess of the floor, the average deduction increases significantly in higher income classes (column 13).

Table 4

PERSONAL DEDUCTION FOR MEDICAL EXPENSES

--Tax Expenditures and Deductions by Expanded Income Class--
(1978 Law and 1978 Levels of Income)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
	All Returns					Returns Itemizing Medical Expenses			Returns Itemizing 1/2 of Insurance Premiums		Returns Itemizing Expenses in Excess of 3 Percent Floor	
Expanded Income (000)	Number of Returns (thousands)	Total Medical Deductions ($ millions)	Total Tax Expenditure ($ millions)	Average Medical Deduction ($)	Average Tax Expend-iture ($)	Number of Returns	Average Medical Deduction ($)	Average Tax Expend-iture ($)	Number of Returns	Average Deduction ($)	Number of Returns	Average Deduction ($)
Below 5	23,019	$ 700	$ 11	$ 30	$ 0	341	$2,052	$ 33	263	$ 126	325	$ 2,057
$ 5 - 10	19,158	2,307	188	120	10	1,910	1,208	98	1,593	120	1,708	1,239
$ 10 - 15	14,099	2,845	388	202	28	3,421	832	114	2,934	121	2,600	958
$ 15 - 20	11,609	2,602	485	224	42	3,951	659	123	3,403	119	2,590	848
$ 20 - 30	12,970	3,383	807	261	62	5,889	574	137	5,325	119	3,133	877
$ 30 - 50	5,838	1,798	613	308	105	3,515	511	174	3,319	121	1,318	1,059
$ 50 - 100	1,429	558	268	390	187	867	643	309	829	129	205	2,204
$100 - 200	299	190	109	635	365	163	1,163	666	157	134	21	7,908
$200 and over	78	63	39	809	501	42	1,500	919	41	123	3	16,642
Total	88,499	$14,447	$2,908	$ 163	$ 33	20,101	$ 719	$ 145	17,865	$ 121	11,903	$ 1,033

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In fact, the increase is so large that the average deduction across all returns -- itemizers and nonitemizers alike -- still increases with income (column 5). This result may occur because of significant price and income elasticities of demand, a greater ability of high-income persons to actually pay off large medical bills, increased amounts of self-insurance as income rises, or a combination of all these factors. Whatever the cause, the effect of the medical deduction on tax liabilities is a regressive redistribution of tax burdens. 12/

12/ The liability effect is clearly regressive. However, the incidence effect may be different and can depend upon such factors as political feedbacks. See Buchanin and Pauly (1970).

V. EFFECT OF TAX EXPENDITURES FOR HEALTH ON THE DEMAND AND PRICE OF MEDICAL CARE.

Generally, employers are indifferent between a dollar paid in the form of a fringe benefit and a dollar paid as a cash wage. Both amount to a dollar of cost to the employer, and both are tax deductible as ordinary and necessary costs of doing business.

However, to the employee, income paid in the form of cash wages is fully taxable, whereas income in the form of employer-paid health insurance premiums is exempted from Federal income tax, State income tax and social security tax. Thus, employees are inclined to accept a larger share of their compensation in the form of health insurance than they would if the income in-kind was taxable. As Section III indicated, this has contributed to the growth in the use of the employer exclusion.

Since the exclusion provision reduces the price employees must pay for health insurance, 13/ it is also likely to increase the demand for health insurance; improved

13/ A further consequence of the exclusion is the inducement for groups to be employer based, rather than to form around other organizations. Employees with employer-based group health insurance are often faced with the loss of their health insurance if they lose or change their job. Thus, these employees may be vulnerable to increase health insurance costs at a time when they can least afford it.

insurance coverage in turn increases the demand for health care. Improved coverage may be reflected in a reduction of the deductible amount, a reduction of the coinsurance amount 14/ or inclusion of previously uncovered services. Since tax rates are higher in higher income brackets, the price reduction -- and the price incentive to increase the quantity of services demanded -- increases with income.

The effect of allowing itemized deductions for health care expenses may be analyzed along the same lines. The deduction for health insurance premiums has much the same effect as the exclusion: it reduces the after-tax price of health insurance or health care, and the reduction is of greater value at higher income levels. The major difference is that the exclusion is available regardless of whether the taxpayer itemizes deductions or takes the standard deduction, whereas the personal deduction for health insurance premiums must be itemized. For the majority of taxpayers who do not itemize, there is no price reduction.

The requirement that medical expenses exceed three percent of AGI before qualifying as a deduction (except for 50 percent of health insurance premiums up to $150) is

14/ The "coinsurance" or "copayment" amount is the percentage of the total bill (after any deductible that might apply) which must be paid by the insured person.

similar to a deductible clause in an insurance policy (Mitchell and Vogel, 1975). Customarily, private insurance deductibles are specified in dollar terms (e.g., $100 per year per family member) rather than as a percentage of income. Specifying the deductible as a percentage of income results in a higher deductible amount at higher income levels. Of course, the smaller the deductible, the larger the share paid by the government.

According to Newhouse, et. al. (1974) a small deductible (e.g., between $50 and $100 per year, per family) should have little effect on the demand for hospitalization; i.e., the effect of insurance would be about the same with or without such a deductible. The cost of an average hospital stay cost was about $1,000 in 1975 (and has increased since then) and, thus, would easily exceed a small deductible.

For ambulatory and other non-hospital services, however, a moderate size deductible is likely to influence demand markedly. As the authors point out, the median individual visits a physician about twice a year at a cost of about $40. At this level of cost, there is a good chance that the recipient of medical care would pay the cost out-of-pocket because the deductible would not be exceeded.

While the three percent floor is roughly analogous to a deductible in an insurance policy, the exclusion of employer premiums and the deduction of all expenses above three percent are both analogous to a copayment rate. The marginal tax rate determines the proportion of the last dollar of medical expense paid by the government; thus, the copayment rate equals one minus the taxpayer's marginal tax rate. Again, the tax incentive for increased use of medical services is greater the higher the taxpayer's taxable income.

The exact effect of these tax subsidies on the overall demand for health services is thus based in large part upon the subsidy rate on marginal expenditures. As noted, on average the Federal income tax expenditures of about $11 billion alone cover approximately 9 percent of total private expenditures for health care. At the margin, however, the reduction in price is much greater than 9 percent. The marginal price reduction is equal to the taxpayers' marginal tax rate -- about 22 percent for the average employee and about 25 percent for the average itemizer. If we also take into account State income taxes and social security taxes, the price reduction climbs to about 29 percent for itemizers and 35 percent for employees. 15/ Since demand is based

15/ This example assumes that the incidence of the employee portion of social security taxes falls on the employee, while, for the employer portion, the incidence rests half on the employee and half on the employer.

primarily upon marginal price, the impact of the tax expenditures upon the demand of medical services is greater than the price reduction averaged across all expenditures would indicate.

Whether increased demand for medical services will actually lead to an increase in the quantity purchased will depend primarly upon the elasticities 16/ of demand and supply. In general, the more elastic either supply or demand, the more likely will the tax subsidy increase the amount of medical care provided in the economy. Often the demand for health care is viewed to be inelastic. However, elasticity at the margin maybe higher for controllable expenses or non-catastrophic events than for uncontrollable or catastrophic occurances. That is, demand for some minimal health care or insurance maybe inelastic, but the demand for additional health care or insurance may be much more elastic.

Because tax subsidies act to increase the demand for medical care, they also tend to increase its market price. A subsidy creates a wedge between the market price received by

16/ The elasticity of demand (or supply) may be defined roughly as the tendency of demand (or supply) for medical goods to change as the price of those goods changes. More precisely, the elasticity of Y with respect to X is the percentage change in Y that accompanies a percentage change in X.

the seller and the net cost to the buyer. Increases in price result in the tax subsidy (or the wedge) being shared with the providers of medical care; thus, the greater the increase in market price, the less the tax subsidy reduces the net cost of medical care to taxpayers.

Generally, the more inelastic the demand for medical care, the lower is the increase in market price as a proportion of the subsidy. On the other hand, to the extent that supply is inelastic, the opposite case holds: tax subsidies are reflected more in increases in price. Insurance complicates considerably the demand side of the medical marketplace. Phelps (1976b) argues that the demand for health insurance is relatively elastic (compared to most estimates of the demand for medical care). Tax subsidies then lead to increased insurance coverage, and increased coverage, in turn, leads to lower copayment rates on medical goods actually purchased. Newhouse (1978) suggests that, once a large proportion of the population faces trivially small copayment rates, the demand side of the market ceases to exert an independent restraint on the market, and medical care price changes, over time, are determined by events exogenous to normal market operations.

In any case, while the tax subsidies may be intended to subsidize only the demanders of health care, in fact, both the demanders and providers are subsidized. To make matters worse, market price increases probably apply fairly uniformly to many types of purchase of medical care, while the value of the tax subsidies increases with the taxpayer's income. Thus, even if the tax subsidy results in a net price (after subsidy) decrease to the average taxpayer, it may still result in a net price increase for low- and moderate-income taxpayers who receive only a small price subsidy. 17/ For those who do not receive any subsidy, a net price increase is almost certain.

17/ A similar argument with respect to the exclusion from taxable income of net imputed rent of owner-occupied homes, together with the personal deduction of mortgage interest and property taxes, has been made by Schreiber (1978). Homeowners with low marginal tax rates may actually pay higher prices net of tax due to the existing tax deduction.

VI. Policy Alternatives

The tax treatment of medical expenses can be changed both directly by legal changes in the exclusion and deduction, and indirectly through changes in other health programs. This section discusses briefly some commonly proposed changes in health policy as they affect tax expenditures for health care.

Limitation of the Exclusion of Employer Contributions. One commonly suggested policy alternative is to treat some or all employer contributions as income to employees. Revenue gain from such a change might then be available for direct Federal expenditures for medical care, e.g., national health insurance. If employees include as income all employer payments for health care and insurance, some personal deduction might be maintained; in that case, the value of employer-provided health insurance and other employer payments for health care would be added to other personal medical expenditures and would be subject to the same limitation or floor (e.g., the current 3 percent AGI limitation) that applies to those expenditures.

Whether the treatment of employer payments as taxable income can be justified depends in part upon the principle of equity under which the income tax base is defined. Under

current law, the implied principle underlying the employee exclusion of employer payments is that the base for individual income taxation should be exclusive of all medical expenses. Under this principle, equal income status is defined as equal ability to purchase non-medical goods; if all medical expenses are viewed as both unwanted and unavoidable, then the well-being of a person can be approximated by his income after payment of all medical expenses. Thus employer payments of medical insurance and care are excluded from income subject to tax.

Inclusion of employer payments, on the other hand, would result in a consistent rule being applied to all medical payments, no matter whether they were paid by the employer or by the taxpayer. If a floor for itemizations were maintained, the implied principle of the current exclusion of employer payments would be abandoned in favor of a principle of deductibility that only "extraordinary" deductions should be allowed.

In addition to considerations of tax equity and revenue loss, other arguments to limit the exclusion are based upon the objective of improving the efficiency and competitiveness of the medical care market. More economical -- less wasteful -- coverage might be gained by requiring employer paid health plans to meet certain standards to qualify for the exclusion.

And the standards might be designed to give employees more choice and, hence, more of an economic incentive to choose less costly plans (Enthoven, 1979).

Including employer payments in income would require some arbitrary administrative rules. Because employees vary in occupation and age, there are market differentials in the prices that they face for private insurance. To charge them equally for employer-provided insurance may not always reflect the relative market value of the insurance that they receive, although similar valuation problems apply as well to other taxable fringe benefits. Alternatively, to calculate the value of the insurance for each employee separately would impose additional administrative burdens upon employers. The final alternative of disallowing the exclusion to the employer, i.e., making the payments taxable to the employer, would also bring about a unfavorable result, for the employer's expense is clearly a cost of doing business, and the employer's marginal tax rate is not a good proxy for the employee's marginal tax rate.

Changing Deduction Floors. Tax expenditures could be decreased or increased by changing the floor for itemized deductions. An increased floor seems to be in line with a measure of ability to pay which allows adjustments to income

only for extraordinary or above average medical expenses. As noted in Section II, the proportion of individuals' incomes spent on medical expenditures has increased in recent years. Taken as a percent of total adjusted gross income, both total and private expenditures for medical care have risen, and this is the primary rationale usually given for increasing the floor. Increasing the floor for medical deductions from three to ten percent and folding in the separate allowance for one-half of insurance premiums, 18/ as proposed in 1978, would have decreased the number of taxpayers itemizing medical expenses by over 80 percent.

On the other hand, as already noted, the inherent logic of the current employee exclusion of employer payments implies that a deduction should be allowed to all taxpayers for all medical expenses. To carry that logic to its extreme would require both elimination of the floor and an allowance for medical deductions to taxpayers who do not itemize. Following the same logic to a lesser extent, a case can be made for not increasing the floor if the employee exclusion is not changed. The higher the floor, the greater is the relative tax on those who buy their own insurance or self-insure and do not receive insurance through an employer.

18/ Casualty losses were also folded into the medical deduction under this proposal.

The question of self-insurance deserves mention in this context. The allowance of a separate deduction for half of insurance expenses (up to $150) was enacted in 1965 partly because of objections from the insurance industry that the deductible amount or floor gave individuals an incentive to self-insure. Since medical expenditures varied, it was argued, a person would be more likely to have expenses above the floor in some years if he did not even out the expenditures over the years through insurance. 19/ The adoption of a higher floor would also reduce the tax benefit of those who self-insure since, at least in certain expenditure ranges, no tax subsidy would be available. Additionally, if individuals are risk averse and risk aversion increases with the size of the risk, then it is less likely that individuals will self-insure for extraordinary expenses than for ordinary expenses. Thus, with a higher floor, not only would fewer non-insured expenses be subsidized, but there may be fewer individuals who would be willing to self-insure for the expenses that remained eligible for the subsidy.

19/ The merit of this argument is debatable. At least for very high medical expenses, only the very wealthy can realistically self-insure. Since most families have a strong incentive to purchase insurance for catastrophic events, and most taxpayers do not itemize, repeal of the separate deduction may have little impact on insurance coverage.

Converting the Personal Deduction to a Personal Credit. A credit could be offered against medical expenses, and the current deduction could be eliminated (or allowed only for expenses in excess of the credit). Depending on the extent to which the credit covers costs, such a proposal could be designed as part of a program of national health insurance, or it could be much more limited in scope. In some national health insurance schemes, the credit serves as a device to provide catastrophic coverage, while other coverage is provided through other means.

Converting the deduction to a credit implies a change in the purpose to which the tax expenditure is directed. A deduction is allowed primarily to define the tax base, i.e., to classify individuals with equal ability to pay taxes. Thus, a taxpayer with $25,000 of income and $5,000 of deductible medical expenses is treated as having equal ability to pay as a taxpayer with $20,000 of income and no deductible medical expenses, all other things being equal. At the same time, since the value of a deduction increases with income, it provides a greater price subsidy to those at higher income levels. A credit, on the other hand, may be viewed as a payment from the government to subsidize the cost of some item -- in this case, medical care -- rather than to adjust the measure of income subject to tax. A credit usually provides an equal level of price subsidy for all

subsidized expenditures at various income levels and marginal tax rates. 20/ Because the purpose of the credit is usually unrelated to the goal of defining the tax base, it is often designed to be available to taxpayers who do not itemize and to nontaxable persons, 21/ as well.

The cost (i.e., revenue loss) of a credit would depend upon the type of proposal that is made. Assume that a personal credit is adopted in lieu of the personal deduction, that there is no increase in price of or demand for health care, and that a credit is available for all private medical expenses. Each one percent of credit would then cost about $1 billion in 1978, with an offset of around $150 million due to the elimination of the current tax expenditure for personal deductions and a reduction in the use of employer-provided insurance.

To lessen the cost of a credit, both a deductible amount and a copayment rate could be applied to the credit. These

20/ Thus we have such terms as "refundable tax credits," even though there is no tax against which the credits are taken. In effect a refundable tax credit is an expenditure administered along with the income tax.

21/ Sunley (1977) argues that, if one could separate involuntary and voluntary medical expenses, then one might want to allow a deduction for involuntary expenses since they reduce ability to pay, but to credit (subsidize) the voluntary expenses.

changes would not only lead to a decrease in the cost of the credit, but they also would limit the increase in demand caused by the government subsidization of health care.

To target a credit most to those in need, a deductible amount should be based on income. 22/ Thus, as with the current medical deduction, only expenses in excess of a given percentage of income would be eligible for the credit. The alternative to a variable deductible amount is a flat deductible amount. A flat deductible, however, is not well targeted to those most in need of assistance, nor does it take into account that demand may increase somewhat with income. Moreover, parameters in the Tax Code are not indexed for increases in income, whether real or inflationary. Over time, a credit with a fixed dollar deductible could lead to a larger and larger proportion of total medical expenses being paid out of public funds. Assuming more than pure inflationary growth in the total amount of medical expenditures, an increase in public share would occur even with a flat dollar deductible indexed for inflation.

22/ One result of varying the deductible with income is that, for certain persons there is an implicit tax rate on increased earnings due to the increase in the amount of expenses not eligible for the credit. For instance, if the credit were to equal 100 percent of all expenses in excess of 10 percent of adjusted gross income, thhen, for a person with $1,500 in medical expenses and $10,000 in adjusted gross income, an extra dollar of earnings reduces the credit by ten cents (from $500 to $499.90).

National Health Insurance. This paper is concerned with tax expenditures rather than national health insurance (NHI). However, adoption of a NHI plan would have substantial effects on existing tax expenditures for health care even without a change in the laws allowing the exclusion and the deduction. The principal change comes about because of the substitution of sources of payment for medical care. If employer payments increase, so do tax expenditures due to the exclusion. If government payments substitute for employer payments, tax expenditures due to the exclusion go down. On the other hand, increases in employer or government payments for medical care both may lead to decreases in direct payments by persons and, therefore, to decreases in the use of the itemized deduction for medical expense. Because the size of the tax expenditure for the employee exclusion is much larger than the tax expenditure due to the personal deduction, the change in total tax expenditures for most NHI proposals is primarily determined by the change in expenditures of employers.

Table 5 shows the change in tax expenditures and other changes in income tax collections due to adoption of selected prototype plans for national health insurance. Since the amount of direct patient payments decline in all cases, there

is a decrease in the use of the personal itemized deduction for medical expenses. Public plans which require increased employer payments raise the tax expenditure cost of the exclusion, while plans which primarily increase government payments decrease the amount of that exclusion.

Any NHI plan might be accompanied by any of the three previously mentioned options: elimination of the exclusion, disallowance of the deduction, or a credit in lieu of a deduction. To the extent that NHI replaces excludable employer payments, elimination of the employee exclusion of employer payments may not result in a large increase in taxable income. A proposal for eliminating the exclusion might properly be based on the argument that all extraordinary costs already would be covered by NHI and that tax-exempt NHI coverage would be approximately equal for all citizens. However, it would be inconsistent if taxable income would include payments for medical insurance and services from employers but not from the government. Furthermore, the problem of attributing the market value of employer-paid insurance premiums to each employee would remain.

Disallowing the itemized personal deduction might also be justified if national health insurance covered all

Table 5

Indirect Effect of National Health Insurance on Income Tax Collections

Expenditure Source	Prototype Plan: Publicly Guaranteed: Change In Expenditures	Prototype Plan: Publicly Guaranteed: Change In Income Tax Collections	Prototype Plan: Public Corporation: Change In Expenditures	Prototype Plan: Public Corporation: Change In Income Tax Collections	Tentative Estimates: Target: Change In Expenditures	Tentative Estimates: Target: Change In Income Tax Collections	Tentative Estimates: Consumer Choice: Change In Expenditures	Tentative Estimates: Consumer Choice: Change In Income Tax Collections
Insurance								
Employer	+ 17.0	- 4.3	+ 24.0	- 6.0	- 5.0	+ 1.3	- 28.0	+ 7.0
Employee	+ 0.5	*	+ 2.0	*	- 2.0	*	- 9.5	+ .2
Private	- 5.0	+ .2	- 5.0	+ .2	- 2.0	+ .1	- 4.5	+ .2
Other Employer	- 1.0	+ .3	- 1.0	+ .3	--	--	- 0.5	+ .1
Direct Patient Payment	+ 14.5	+ .6	- 14.5	+ .6	- 8.0	+ .3	- 8.5	+ .3
Federal	- 29.0	--	+ 20.0	--	+32.5	--	+ 72.0	--
Total	+ 26.0	- 3.2	+ 25.5	- 4.9	+15.5	+ 1.7	+ 21.0	+ 7.8
Addendum:								
- If add employer tax credit of $5 billion	--	+$1.3	--	+$1.3	--	--	--	--
- If increase excise taxes, increase employer payments to a payroll tax or add to a value added tax of $5 billion	--	-$1.3	--	-$1.3	--	-$1.3	--	-$1.3

* Less than $50 million

Office of the Secretary of the Treasury
Office of Tax Analysis

January 4, 1979

extraordinary costs. Still, the more coverage provided by NHI, the less the possibility that out-of-pocket health expenditures would exceed three percent of adjusted gross income. Thus, while eliminating the deduction might be justified, the revenue effect is of less significance because fewer taxpayers would exceed the floor.

Finally, a tax credit might very well be the form in which insurance for catastrophic events is offered under NHI. Depending upon the size of the credit, the personal deduction might or might not be eliminated. If not eliminated, it would only be allowed for expenses in excess of those not covered by the credit. If the credit is large enough, however, there may be no cases in which expenses would exceed a floor, and, thus, no need for the deduction.

VII. CONCLUSION

Tax expenditures for medical care form a large and growing part of the Federal budget. Employer payments for medical care have always been exempted from income taxation, and an increasing proportion of total private medical payments are exempted from tax because of the increase in coverage provided by employers. The personal deduction was first allowed in 1942 and has been expanded since then to cover expenses which might be considered quite ordinary today.

For 1979 Federal income tax expenditures for medical care will exceed $11 billion and will comprise about 5 percent of total expenditures for medical care and about 9 percent of private expenditures. State income tax and social security tax collections are also reduced by another $6 billion. While not as large as direct expenditure programs such as Medicare and Medicaid, these tax expenditures do have an impact upon the demand and price of medical care. At the margin, these expenditures often reduce price by 29 to 35 percent.

Practically all policies connected with medical care affect the amount of tax expenditures for medical care.

Direct expenditures may change tax expenditures even if the laws affecting the exclusion and deduction are unchanged. The design and choice of tax expenditure policy is dependent upon the extent to which medical exclusions and deductions are to be made equally available to all persons, the amount of ordinary expenditures which are to be disallowed a deduction, and the extent to which other public expenditures are used to offset costs of health care.

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FOR IMMEDIATE RELEASE July 9, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,900 million of 13-week bills and for $3,001 million of 26-week bills, both to be issued on July 12, 1979, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 11, 1979			26-week bills maturing January 10, 1980		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.669 a/	9.222%	9.60%	95.389 b/	9.121%	9.72%
Low	97.650	9.297%	9.68%	95.355	9.188%	9.80%
Average	97.658	9.265%	9.65%	95.367	9.164%	9.77%

a/ Excepting 2 tenders totaling $640,000
b/ Excepting 1 tender of $10,000

Tenders at the low price for the 13-week bills were allotted 60%.
Tenders at the low price for the 26-week bills were allotted 87%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 40,270	$ 40,270	$ 31,960	$ 31,960
New York	3,543,725	2,384,725	3,563,360	2,560,860
Philadelphia	21,925	21,925	11,845	11,845
Cleveland	45,005	35,005	22,775	22,775
Richmond	39,380	39,380	41,335	41,335
Atlanta	43,620	43,620	30,280	30,280
Chicago	189,475	109,475	170,295	65,295
St. Louis	39,605	18,605	38,020	17,020
Minneapolis	13,600	13,600	11,870	11,870
Kansas City	49,180	49,180	36,680	36,680
Dallas	19,510	19,010	10,830	10,830
San Francisco	206,960	89,960	206,770	108,770
Treasury	35,620	35,620	51,440	51,440
TOTALS	$4,287,875	$2,900,375	$4,227,460	$3,000,960
Type				
Competitive	$2,571,470	$1,183,970	$2,793,115	$1,566,615
Noncompetitive	514,005	514,005	396,245	396,245
Subtotal, Public	$3,085,475	$1,697,975	$3,189,360	$1,962,860
Federal Reserve and Foreign Official Institutions	$1,202,400	$1,202,400	$1,038,100	$1,038,100
TOTALS	$4,287,875	$2,900,375	$4,227,460	$3,000,960

1/Equivalent coupon-issue yield.

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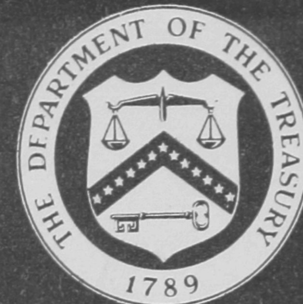

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STATEMENT OF
THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
July 10, 1979

Mr. Chairman and members of this distinguished Committee:

I appear before you today to discuss our nation's energy crisis, particularly as it relates to crude oil.

I will first review the severe energy problems we face. Then, I will turn to the President's program: his decision to decontrol crude oil prices, the imposition of a windfall profits tax on domestic crude oil production, the creation of an Energy Security Trust Fund, and revisions of the foreign tax credit.

Nature of Our Energy Problem

At the core of our energy problem is the country's dependence on crude oil imports to supply our energy demands. We supply less than 60 percent of our needs from domestic production despite gains from Alaska. As a result,

° our economy remains vulnerable to interruption of our crude oil supplies for a variety of reasons, including political instability in foreign countries;

° our economy remains vulnerable to sharp and inflated increases in the price of oil which enlarge our trade deficit, threaten the value of the dollar, and erode real incomes;

° our economic planning remains vulnerable to the unscheduled and unpredictable pricing decisions of a foreign cartel.

These problems are not unique to the United States. They are shared by all the oil importing countries of the world. The harsh reality of our situation was evident even before OPEC's decision in June to raise once again the posted price of crude oil. The cutoff of production from Iran had diminished world petroleum stocks and sent the price of crude oil soaring. As of the beginning of June 1979, world oil prices (outside of the spot market) had reached an average of over $17 per barrel, an increase of more than 38 percent from December 1978. The effects of the cutoff in Iranian production, gasoline shortages and rising prices for refined products, were already rippling through the economy.

Our domestic energy problems were strained further by the June OPEC price increase, despite the moderation shown by some countries and despite Saudi Arabia's decision to increase temporarily its level of production. OPEC's price of $18.00 for Saudi marker crude was coupled with allowances for surcharges and quality and location differentials of up to $5.50. We now calculate that this will translate into an average OPEC oil price of between $20 and $21, an increase of about 60 percent since December, 1978.

The oil price increases this year, when compared to the schedule announced by OPEC last December, increase the likelihood of a recession. The direct, first round effect of increases made since December, 1978 will be to cut 1 percent from our growth rate in 1979. By the end of 1980 the level of GNP will be 2 percent below what would otherwise have occurred. The rate of inflation will rise by 1 percent in 1979 and another 1 percent in 1980 above what it would have been. Unemployment will increase by 250,000 by the end of 1979 and another 550,000 by 1980, for a total of 800,000. Total OPEC pricing actions this year will add about 12 cents a gallon to the price of gasoline and heating oil, assuming a straight dollar and cents pass through.

<u>The President's Program</u>

President Carter took the lead in curbing our dependence on oil imports long before the latest round of OPEC increases, and he responded with decisive leadership at the Tokyo Summit after the most recent OPEC price increase was announced.

In March, 1979 we agreed 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. At the Tokyo Summit the President pressed for and won a more extensive commitment. In addition to limits on oil imports in 1979 and 1980, specific goals for each country were set for 1985. The U.S. goal for 1985 is the same as the goal for 1979 and 1980 -- 8.5 million barrels a day.

This is an ambitious goal, and it will require much sacrifice. We must move forward along the lines the President is already implementing and along the lines the Administration will propose soon. Close coordination between the Administration and Congress is essential if we are to achieve these goals.

The two key elements of the program already set in motion by the President are:

° phasing out price controls on domestic crude oil, and

° proposing a windfall profits tax.

The Decontrol Program

The first element in the President's program is the phasing out of the perverse 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 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 the system, 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 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, on April 1 of this year, the country was facing a price of $17.55 a barrel for imported oil on the world market. But the controls-and-entitlements system established an average refiner price of $14.52 per barrel, regardless of source. As a consequence there was an effective, federally-mandated incentive of $3.03 per barrel to import oil, rather than use domestic oil, and a like incentive 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 the price for imported oil of $17.55 in April, these controls constituted a straightforward signal to oil owners to invest in more profitable ventures, either here or abroad.

The President's decontrol program will end the subsidy to consumers of oil, encourage conservation and substitution of other energy sources, and provide the appropriate incentives to expand domestic oil production. The route chosen will delay as much of the inflationary impact of decontrol until 1981 or 1982 as practical while maximizing the incentive to increase production in 1979 and 1980.

The major features of the President's decontrol program 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 through 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 was decontrolled, as was that volume of production from any oil field that results from introducing tertiary recovery programs.

° Eighty percent of production from marginal wells -- that is, wells producing less than specified amounts of oil in 1978 -- was allowed to sell at the upper-tier price beginning June 1, 1979. The balance is to be released to the upper tier on January 1, 1980.

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.

Another key aspect of 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.

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 discovery and production. To recapture some of these windfall profits, while at the same time preserving production incentives, we have proposed to tax a portion of the windfall profits generated by decontrol and by recent and future OPEC price increases. An additional portion of the windfalls will automatically be recovered through existing federal income tax laws.

1. The Administration Proposal

The President proposed a 50 percent tax 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 recent and 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 tax would apply beginning January 1, 1980 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.

B. Upper-tier

The tax on upper-tier oil would 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, 1991.

C. Uncontrolled tier

The third base of the windfall profits tax applies to most uncontrolled 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.

2. The House Bill

The House approved the basic structure of the windfall profits tax, but did make a few significant changes. In view of the overall supply and revenue impacts of the House bill, we believe that the House has adopted a basically sound approach to the problem of windfall profits. We greatly appreciate the prompt and reasoned action of the House and the cooperation and encouragement provided by the House leadership.

The House bill, like the Administration bill, imposes an excise tax on the difference between the amount received for domestically-produced crude oil, and a base price. The tax is imposed on three different bases, derived approximately from the existing price control structure. The bases corresponding to existing production would gradually be phased out. Incentives are provided in order to stimulate production for oil (such as incremental tertiary) which is especially difficult to produce. The revenues derived from the tax are to be set aside in a special trust fund.

The Administration endorses the overall approach taken by the House. I will, therefore, not take time here to review each of the elements of the House bill. Rather, I would like to discuss with you those differences between the House bill and the Administration bill which are of particular concern to us, and the reasons why in certain instances we would prefer that you modify the House bill. In addition, there are certain issues not specifically covered by the legislation which merit your attention.

3. Windfall Profits From Uncontrolled Tier

The Administration proposed a permanent tax on production that is now decontrolled or effectively decontrolled, and therefore is able to earn the world market price. This

includes oil from 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. This base also includes oil from producing reservoirs as this oil is decontrolled and the windfall profits tax on lower and upper tier oil gradually phased out.

The House bill divides the tax on the uncontrolled tier into two parts, only one of which is made permanent. Newly discovered oil and incremental tertiary oil are taxed at a 50-percent rate on receipts between $17 and $26 per barrel, and a 60-percent rate on receipts in excess of $26. The $17-26 base is adjusted for inflation plus 2 percent. The tax on these two categories of oil terminates abruptly on December 31, 1990. The balance of oil in the uncontrolled tier is taxed in a manner similar to the Administration's proposal, except that a 60-percent rate applies. This part of the tax is permanent.

A. Permanency

The Administration believes that both parts of the uncontrolled tier should be permanent.

It has been argued that a permanent tax on the uncontrolled tier would permanently condemn 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 is not determined by the workings of a free market where supply and demand equate price to the marginal cost of production. Since 1973, it has been set by a cartel well above the cost of production. Given these circumstances, there is no economic reason for allowing producers of domestic oil to receive the world price of oil on their production.

It has been argued that the imposition of a windfall profits tax on increases in the world price in excess of inflation will drive producers toward foreign exploration. This is simply not true. The United States is not unique in seeking to capture a portion of higher oil prices. 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. In the United Kingdom,

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 could compel a return to regulation. It is preferable to risk sacrificing the very small potential supply response in order to avoid such a situation.

B. Threshhold price and inflation adjustment

The Administration recommends that the entire uncontrolled tier tax base begin at $16 per barrel and be adjusted no more rapidly than the domestic inflation rate. The House bill treats newly discovered and incremental tertiary oil specially, starting the tax at $17 per barrel and adjusting for domestic inflation plus 2 percent.

The Administration's $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.

It has been suggested that the $16 base be increased because recent OPEC surcharges and the increase in the price of Saudi marker crude 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 from the windfall profits tax the profits domestic producers are realizing from these recent increases.

Allowing the tax base to be adjusted upwards by 2 percent more than inflation seems excessive. The price received by oil producers should increase no more rapidly than the general price level. The argument that drilling costs have risen more rapidly than inflation is simply not a sufficient justification for providing the very generous 2 percent additional adjustment.

C. Tax Rate

We agree with the reduced tax rate provided in the House bill for newly discovered and incremental tertiary oil when receipts are not more than $26 per barrel.

4. State-owned Lands

Under the House bill, income from interests in oil production owned by State or local governments, or their instrumentalities, is exempt from tax if it is dedicated to public education. The Administration's bill did not have this exemption.

The Administration opposes the House "education" exemption and recommends that it be deleted from the bill. The exemption bears no relationship to oil production or to windfall profits. It is, in effect, a form of "revenue sharing" to subsidize certain educational activities in states fortunate enough to have oil-bearing lands. If these activities are in need of a subsidy, there are surely more direct, simpler, and fairer means than providing a special exemption from the windfall profits tax. After all, under decontrol, even with a windfall tax, revenues for these educational purposes will increase substantially. Moreover, these additional revenues are not subject to income tax.

5. Alaskan Oil

The House bill taxes certain Alaskan oil production to a limited extent. The Administration bill would have exempted Alaskan oil entirely from the tax, even though Alaskan oil currently being produced is upper-tier oil under the oil price control program.

The exemption in the Administration bill was based on the large differential between the wellhead price for Alaskan oil (only $5.40 a barrel when the proposal was made) and the $13 control price which is also the threshhold level

for the upper-tier windfall tax base. It was believed that since the wellhead price of Alaskan oil would not soon approach the threshhold tax level, an outright exemption was preferable to the administrative inconvenience of requiring producers to demonstrate that their oil was not taxable.

World oil prices have surged dramatically since the Administration proposed its windfall profits tax. The assumption underlying the Alaskan oil exemption is no longer valid. Consequently, the Administration has no objection to taxing oil from existing Alaskan production. This is entirely consistent with the overall policy behind the windfall profits tax.

We believe, however, that the threshhold tax level in the House bill is too low. Since Alaskan oil does not benefit from decontrol until the wellhead price reaches $13 per barrel, we would prefer that Alaskan oil from the Sadlerochit reservoir be taxed as upper-tier oil. Newly discovered Alaskan oil should be exempt from the windfall profits tax.

6. Windfall Profits Tax and Production Capital

Some have argued 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 cash flow argument is premised on the untenable proposition that those now engaged in the exploration for oil and gas deserve a cheap source of capital while new entrants should pay the market price for capital. This is inconsistent with common-sense rules of fair play in a competitive economy, because it would further impede entry by non-oil firms into oil production and thus reduce competition.

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 windfall profits tax relief for oil producers. 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 an abritrary forgiveness of the tax -- will not necessarily add to domestic oil production.

Proponents of plowback argue that it provides assurance that this additional income would be reinvested only in domestic oil production. However, as a targeted subsidy, a 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 look for, find, and produce oil, and it is discovery leading to production by anyone, not merely those who presently own oil, 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.

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.

Under the President's proposal, the Fund would 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.

Although the House adopted the general concept of a trust fund, it made several important changes to the President's proposal. The program specifications were left out; general revenue financing was dropped; and the charge against the Fund for new tax expenditures deleted.

We believe that the Trust Fund should be augmented by the increase in federal income taxes from decontrol collected through fiscal year 1982. It is important that this revenue be available to finance Trust Fund programs. In addition, for reasons of sound fiscal as well as energy policy, it is essential that any new energy tax expenditures be charged against the Fund. This would provide at least some measure of accountability for subsidies that are functionally equivalent to direct spending programs.

Foreign Tax Credit

The President is also proposing certain changes in the way the foreign tax credit applies to oil and gas income.

The foreign tax credit is fundamental to the United States system of income taxation. It is intended to prevent the double taxation of income earned abroad. To ensure that the credit operates as intended, the Treasury Department has recently proposed new regulations to clarify existing law on the standards to be applied in determining when a payment to a foreign government qualifies for the credit.

Our legislative proposal is designed to improve the credit in one important area. In essence, the proposal seeks to ensure that income taxes paid to a foreign country on income from oil extraction in that country may be credited against the U.S. tax on that same income, and only on that same income.

There are already special rules in the law, introduced in 1975 and modified in 1976, which limit the credit available for foreign taxes paid on income from oil extraction. The amount of foreign taxes paid on such income which may be claimed as a foreign tax credit is limited to the U.S. corporate tax rate times foreign oil extraction income. That credit may only be used against the U.S. tax on income from foreign oil extraction or from other foreign oil-related activities. Thus, the President's proposal builds upon concepts inherent in existing law.

There are, however, some defects in present law which prevent it from operating as intended: to limit the credit for extraction taxes to the U.S. liability on the very same income that was burdened by those taxes. As a result of those defects, high taxes paid on foreign oil production and losses generated by foreign drilling expenses in a particular

country may still reduce U.S. tax on other income. Although these defects are highly technical, they are also highly important.

Our proposal would cure these defects by making three changes. First, the foreign tax credit with respect to oil extraction income would be strictly limited to the U.S. tax on extraction income. We would accomplish this by requiring that the credit for taxes on foreign oil extraction income be computed separately from the credit on all other foreign income. Thus, extraction taxes or losses will no longer be able to shelter other income, such as foreign shipping or refining income, from U.S. tax. Second, the credit for foreign oil extraction taxes would be limited to the lesser of the amounts computed on a country-by-country or overall basis. Where there are substantial losses, the overall limitation will be retained to prevent the losses from reducing U.S. tax on U.S. source income. But where there are no such losses, the country-by-country limitation will prevent the averaging of high taxes and low taxes to the detriment of the U.S. Treasury. Third, the proposal provides for the recapture of the U.S. tax benefit attributable to extraction losses incurred in any given foreign country. Recapture will apply in a situation where a loss reduces U.S. tax, and a later gain in the same country generates taxes. Without recapture, the allowance of both the loss and the foreign tax credit would represent a double benefit.

The proposal is estimated to increase U.S. tax liability by about half a billion dollars at current (1979) income levels. Considered in the context of the Administration's overall energy package, the proposal should not curtail the incentive to look for new sources of oil.

Economic Impacts

Our initial estimate, based on an assumption of no real increases in OPEC prices, was that the additional inflation resulting from phased decontrol compared to retaining controls indefinitely would have been 0.1 percent in 1979 and 0.2 percent on average over the next three years. By 1982, the level of the consumer price index would have been approximately 0.75 percent higher. We also estimated a case in which world oil prices rose 3 percent a year faster than world inflation. Under this case, the level of the consumer price index in 1982 would have been 0.9 percent higher than otherwise.

Of course, OPEC has raised its prices at a far higher rate than we forecast. However, the basic conclusion we reached earlier -- that the inflation rate is not substantially affected by phased decontrol -- is unchanged. This is because price controls govern only about a third of the oil consumed by the United States. The remaining two-thirds (imports, stripper production, and Alaskan oil) are already free to receive the world price.

Let me illustrate. By the fourth quarter of 1980, we estimate that the inflation rate will be approximately 0.3 percent higher under a revised decontrol path which takes into account the most recent OPEC increases. This represents an increase of 0.1 percent in our earlier forecasts. To put this into perspective, we estimate that, by the fourth quarter of 1980, OPEC price increases above the December, 1978 schedule will be adding a full 2 percent to the inflation rate, even if OPEC imposes no additional real price increases in the interim.

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 nonenergy 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 half a million barrels per day in 1981 and 1.3 million barrels per day by 1985, assuming OPEC prices increase only with inflation. Should OPEC raise prices at a rate in excess of inflation, the oil import savings would be greater.

Conclusion

In the past we have refused to address the problem of oil prices 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.

The President has proposed a way to resolve 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. He now needs your assistance to complete the program.

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

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Revenue Effects of Decontrol and the Windfall Profits Tax
as Passed by the House of Representatives
and as Endorsed by the Administration

Assuming a $22.00 Uncontrolled Oil Price, 1979-III,
and No Real Price Increase

Calendar Year Liabilities, 1980-84

($ millions)

	Calendar Years				
	1980	1981	1982	1983	1984
.R. 3919 as passed by the House:					
Change in tax receipts before the windfall profits tax	2,983	7,665	10,339	10,925	11,542
Net windfall profits tax 1/	3,539	7,312	8,990	8,603	8,125
Total, decontrol and windfall profits tax	6,522	14,977	19,329	19,528	19,667
:venue effect of changes proposed by the Administration:					
Tax newly discovered and incremental tertiary oil on the difference between the sales price and $16.00 adjusted for inflation	84	170	315	546	898
Eliminate the exemption for state and local royalties allocated to public education	245	380	446	441	434
Tax Alaskan oil other than newly-discovered oil as upper-tier oil	-705	-726	-713	-699	-685
Net revenue effect of proposed changes	-376	-176	48	288	647
control and the windfall profits tax as endorsed by the Administration:					
Change in tax receipts before the windfall profits tax	2,990	7,659	10,311	10,864	11,437
Net windfall profits tax 1/	3,156	7,142	9,066	8,952	8,877
Total, decontrol and windfall profits tax	6,146	14,801	19,377	19,816	20,314

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Office of Tax Analysis

July 9, 1979

Windfall profits tax net of the income tax offset due to the deductibility of the windfall profits tax.

:e: The revenue effect details of the proposed changes are dependent upon the order in which they are listed; that is, on the assumption that preceding modifications are effective.

Energy Security Trust Fund Receipts under the Windfall Profits Tax Endorsed by the Administration

Assuming a $22.00 Uncontrolled Oil Price, 1979-III, and No Real Price Increase

Fiscal Years 1980-84

($ millions)

	Fiscal Years				
	1980	1981	1982	1983	1984
Energy security trust fund receipts:					
Income tax receipts before the windfall profits tax	1,385	5,056	8,833	--	--
Windfall profits tax:					
Gross windfall profits tax	2,907	9,311	14,694	14,747	14,517
Income tax offset	-863	-3,067	-5,039	--	--
Windfall profits tax allocated to the trust fund	2,045	6,244	9,655	14,747	14,517
Total, trust fund receipts	3,430	11,300	18,488	14,747	14,517

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July 9, 1979

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

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FOR IMMEDIATE RELEASE
Monday, July 9, 1979

Contact: John P. Plum
202/566-2615

CHINESE FINANCE MINISTER ZHANG JINGFU HEADS DELEGATION TO U.S.

Chinese Finance Minister Zhang Jingfu heads a delegation arriving here tomorrow, at the invitation of Treasury Secretary W. Michael Blumenthal, for a two-week visit to learn more about the United States while continuing discussions initiated by Secretary Blumenthal on his visit to China early this year.

The 13-member delegation, including Vice Minister of Finance Xin Yuanxi, will be guests of Secretary Blumenthal at a welcoming dinner Tuesday evening. On Wednesday, July 11, the delegation is scheduled to meet with Secretary Blumenthal and with Congressional leaders, Federal Reserve Board Chairman William Miller and Export-Import Bank Chairman John L. Moore.

Minister Zhang's delegation will have an opportunity to see how private enterprise and local government operates in the United States in visits to New York, Chicago, Kansas City, Dallas, and San Francisco.

In New York July 12 and part of July 13, the group will meet with banking and financial interests, returning to Washington July 13 for further discussions with Treasury Department officials. On Saturday, July 14, the mission goes to Chicago for three days of meetings with financial and industrial leaders, and will meet Mayor Jane Bryne.

The delegation is scheduled for Kansas City, MO., Tuesday, July 17, for briefings on farm cooperatives and agricultural industries, as well as a tour of a research and demonstration farm.

In Dallas, July 18 and 19, the group will meet business and financial leaders and will visit several industrial plants, departing July 20 for San Francisco and four days of meetings there with banking, industrial and educational leaders. The delegation is scheduled to return home July 24.

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FOR RELEASE AT 4:00 P.M. July 10, 1979

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $5,900 million, to be issued July 19, 1979. This offering will not provide new cash for the Treasury as the maturing bills are outstanding in the amount of $5,923 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $2,900 million, representing an additional amount of bills dated April 19, 1979, and to mature October 18, 1979 (CUSIP No. 912793 2R 6), originally issued in the amount of $3,021 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated July 19, 1979, and to mature January 17, 1980 (CUSIP No. 912793 3M 6).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing July 19, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,731 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, July 16, 1979. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

B-1714

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. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. 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. 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, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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 on July 19, 1979, in cash or other immediately available funds or in Treasury bills maturing July 19, 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.

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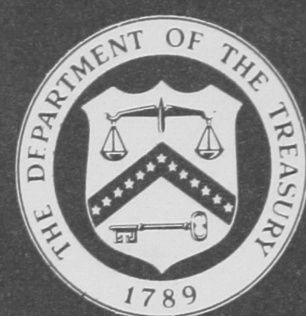

STATEMENT BY
THE HONORABLE ANTHONY M. SOLOMON
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
BEFORE SUBCOMMITTEES 1/ OF
THE HOUSE BANKING, FINANCE AND URBAN AFFAIRS COMMITTEE
JULY 12, 1979

This series of hearings which the Subcommittees have called will make a valuable contribution to the understanding of the functions being performed by the Eurocurrency market as well as of the problems associated with the operation of that market. I am pleased to have the opportunity to express the views of the Treasury Department on these questions and also to comment on the legislative proposals to deal with these problems contained in HR 3962.

The international extension of credit is an essential ingredient of the flow of international goods and services which is critical to the economic health and prosperity of the United States and the world as a whole. In the early 1970's, the current account deficit of all countries in a deficit position taken together,* averaged about $15 billion annually. Those deficits were financed by international credit.

The quadrupling -- or quintupling -- of the price of oil in 1974, together with other, less significant factors, caused a veritable explosion in current account imbalances so that, beginning in 1974, the aggregate deficit has averaged over $75 billion annually. The amount of net international credit required to finance these deficits expanded accordingly.

Obviously, there were surpluses which aggregated to an equal magnitude** which required the placing of investments abroad. In practice, there are flows in both directions in both surplus and deficit countries.

A portion of the financing -- broadly speaking, about one-quarter -- was provided by governments and by multilateral institutions (through export credits, development loans, balance of payments financing, etc.), but the great bulk of this international credit was arranged through the private markets.

1/ On Domestic Monetary Policy and on International Trade, Investment and Monetary Policy

* Defined as those remaining in deficit after taking account of official grants

** In most of the published estimates the aggregate of the deficits does exceed the aggregate of the surpluses because of statistical problems but conceptually there must be a balance.

B-1717

Banks, firms and individuals in surplus countries invested these national surpluses abroad wherever and in whatever assets they found best suited to their investment needs. Most of these investments were placed in public and private securities and deposits in various foreign money and capital markets and the Euromarket. Some government agencies also accrued and invested surpluses just as private entities do.

In some countries when foreign exchange was offered on the foreign exchange market, monetary authorities purchased the funds. They did so, either to increase their official reserve assets or as a by-product of market intervention to prevent exchange rate movements, and invested that foreign exchange in foreign government securities or bank deposits. These transactions provided a pool of funds on which commercial and investment bankers could draw in order to lend to countries in deficit. The banks performed the standard intermediary function familiar in domestic financing.

Years ago these transactions were handled in the domestic money and capital markets of the United States and -- to the extent allowed by governmental restrictions -- of other major industrial countries. What is known as the Eurocurrency market system developed in part because access to domestic markets was restricted and in part because the Eurocurrency arrangements offered slight but important competitive advantages. European banks, prevented by governmental restrictions from extensive foreign lending operations in their own currencies, were able to operate in other currencies, either at home or abroad. By using foreign currencies, primarily the dollar, they could participate in this rapidly burgeoning business.

U.S. banks turned to branches abroad as the channel for expanding their international lending operations, in part because of limitations on expanded lending under the U.S. voluntary restraint programs introduced as a balance of payments measure in 1965 and strengthened in 1968. Thus, by the time the controls were removed in 1974 the overseas branching operations of U.S. banks had been well established.

With the removal of the U.S. controls and the relaxation of controls by some of the other countries, the questions of competitive advantage and convenience of operating through branches and subsidiaries overseas has become more important in determining where the transactions is booked. None of the major industrial countries which require that banks operating within their territories hold reserves against their liabilities apply those requirements to the liabilities of the foreign branches or subsidiaries of their banks. Thus, offshore operations are slightly cheaper than operations of head offices.

There may be other factors as well -- in some cases offshore operations offer some tax advantages. Furthermore, there are cost advantages in operating what is essentially a wholesale

market confined to large transactions. As a result, most of the growth in international credit has been provided through this Eurocurrency mechanism rather than through the home offices of banks in their domestic currencies. For example, it is estimated that at the end of 1978 only 17 percent of outstanding dollar credits to foreign borrowers by U.S. banks was booked through domestic offices, the remainder being extended through foreign branches.

Largely because the demand for international credit is now so large (and the volume of surplus country funds seeking placement is so large), the size of the Eurocurrency market and the rate of its growth have led to expressions of concern and to fears that:

-- the Eurocurrency market was itself generating or creating excessive amounts of credits,
-- banks were incurring excessive risks,
-- the ready availability of such large sources of credit contributed to destabilizing speculation on the foreign exchange markets,
-- and more recently, that the Eurocurrency market was complicating efforts to appraise and manage domestic monetary conditions.

These are serious questions, and they deserve careful study.

We must expect the amount of international credit outstanding to continue to increase. The volume of world trade is growing; prices are rising and with these increases the need for financing rises. Imbalances in world payments will not be reduced quickly. Positions of some countries may improve in the future, but for others the reverse may occur. The further escalation of oil prices which we have seen in recent weeks is, in fact, likely to result in larger global imbalances and in demands for even more international credit recycling.

Obviously we need a financial system which "recycles" or channels the funds accruing to coutries in current account surplus to those seeking to finance deficits. We need a system which provides credit to obviate the necessity for abrupt, severe and disruptive contraction of imports by deficit nations.

On the other hand, a financial system which makes credit too easily available to countries with weakening payments positions and growing internal inflation may add to world inflation and may delay the initiation of desirable adjustment policies until crisis is inevitable. Does the Eurocurrency market, with banks in many nations competing intensively for loan business, have a tendency to produce this result? Some analysts feel that it does. Or is this competition a largely inevitable result of the large amounts of liquid international assets that are accumulating in surplus countries and not being invested in longer term investments?

The volume of credit these markets could extend would be

somewhat reduced if the Eurobanks could -- effectively and equitably -- be made subject to some type of reserve requirement. It is argued that this action, if it could be implemented successfully, might slow the growth of total international bank assets and liabilities, easing inflationary tendencies, encouraging weak borrowers to turn more quickly to the official international financial institutions, and adopting stabilization policies before their situations become so acute that severe restraints are unavoidable. Others feel that the imposition of reserve requirements on the Eurocurrency market would simply shift a portion of the lending to national credit markets and have very little impact on the overall volume of international lending.

There are no firm answers to these questions. The existence of this reserve-requirement-free market probably does have some effect on the total volume of international lending and on world inflation, particularly at times when national authorities are exercising restraint. My own feeling, however, is that the impact is quite modest. Imposing reserve requirements on this market would not be a magic cure-all for world inflation.

Also highly uncertain is the degree to which the imposition of reserve requirements on the Eurocurrency market might shift the focus of operations back to national markets. Conceivably, a significant portion of the operations now booked through "shells" in the Caribbean and elsewhere, where risk of major change in local governmental rules and regulations is sometimes considered a factor, might, over a period of time, be shifted to head offices as a result of the reduction in the extent of the competitive advantage. Operations from major financial centers in Western Europe which have a pool of managerial and banking expertise might be less affected.

Certainly for the next few years at least we must expect that the Eurocurrency market will continue to have a competitive advantage over the national markets. We should not, therefore, be surprised to see further substantial increases in the volume of Eurocurrency assets and liabilities. A high percentage of these increases is likely to be in dollars. Such increases do not automatically bring pressure on the dollar in the foreign exchange market. That pressure will depend on the changing market demand for dollars relative to other major currencies.

It is erroneous to view the level of dollar deposits in Eurocurrency banks as a measure of "unwanted dollars" or dollar overhang. There is no logic in the assumption that dollars are deposited in banks in the U.S. if the holder (whether a foreigner or a resident of the U.S.) "wants" them and depositied in the Euromarket if he considers them excess or "unwanted." The decision as to whether a depositor will place his funds in a bank within the U.S. or in a Eurocurrency bank is, at least for most investors, primarily a matter of where he can obtain the best yield. This consideration even leads some of the smaller central banks to place a portion of their funds in the Eurocurrency

market where they can earn higher interest rates.

Some of the major central banks, however, have a gentlemen's agreement not to increase their holdings in the Eurocurrency market, which means that they may be expected to place any increased dollar claims with domestic U.S. banks or in U.S. Government securities. Also, the Federal Reserve has requested that foreign branches of member banks outside the U.S. not solicit deposits from U.S. residents unless such deposits serve an international purpose.

Related to concern about excessive Eurocurrency credit is a fear that, under the pressure of competition for business, banks in the Eurocurrency market extend high risk credits which would be subject to criticism from bank supervisory authorities if extended by home offices in domestic currencies. I am confident that this is not a problem as far as U.S. banks are concerned.

Our banks operate in the Eurocurrency market largely through branches, and our regulatory authorities examine the worldwide activities of each bank, not merely its head office activity. Our bank examiners actually go into most branches overseas as well as many subsidiaries, in addition to the head offices. They have authority to obtain information on branches and subsidiaries from the head office and from other foreign offices. Thus, the degree of supervision of the Eurocurrency activities of U.S. banks abroad is quite comparable to that of their domestic activities.

Laws, regulations and institutional methods differ among countries, however, and I am in no position to judge whether excessive risk is a problem for operations of non-U.S. banks conducted outside the home country. Most Eurocurrency operations of German banks, for instance, are conducted by subsidiaries established outside Germany rather than through branches. German supervisory authorities apparently have little authority over these subsidiaries and, in fact, are not able to obtain as much information about their activities as they feel appropriate.

The charge that the Eurocurrency banks contribute to destabilizing currency speculation needs to be weighed in the context of a recognition that the pool of highly liquid funds available to these banks is extremely large, that the system of interbank lending is highly developed, and that the communication facilities for global operations around the clock are extensive. Thus, the facilities of the Eurocurrency banks can be used by large operators in the exchange market to mobilize large sums in a matter of minutes. The accusations that banks themselves have engaged in collusive speculative maneuvers are not, however, supported by our data on changes in banks' net positions in specific foreign currencies.

The aspect of the Eurocurrency market operations which is of greatest concern to the U.S. is the nature of its effect on domestic monetary policy management. This is, of course, the

responsibility of the Federal Reserve System, and Governor Wallich has already discussed this issue with you.

I am appending to my testimony a slightly revised and updated version of an Assessment of the Financing of Payments Imbalances and Activity in International Capital Markets which I provided a few weeks ago to the Subcommittee on International Finance of the Senate Banking Committee. It provides factual detail on Eurocurrency market activity and the Eurodollar element of that market.

The general policy issues surrounding the Eurocurrency market are of current concern both to governments and central banks in most of the major industrial countries. Detailed studies of these problems are being conducted in central bank channels, but the broader questions have also been discussed at a meeting of the Deputies of the Finance Ministers and Central Bank Governors of the Group of Ten and Switzerland. Finance Ministers of a number of countries are following the studies under way in the central bank channels and are encouraging and supporting these studies.

One suggestion which the U.S. has raised for consideration is the possibility of applying uniform reserve requirements to Eurocurrency liabilities in somewhat the same manner as most countries do with respect to domestic bank liabilities. The Federal Reserve staff prepared a paper on this subject for consideration by the central banking group. That group is currently examining; (a) whether there is need for any further action to regulate Eurocurrency operations; and (b) if it should appear that some action was desirable, what type of action would be advisable. The application of Eurocurrency reserve requirements is one -- but not the only -- type of measure which would be considered by this group. As Governor Wallich has indicated, this work is actively under way.

The Eurocurrency market has become a very important element in a global system. We want this market to remain strong and to continue to fulfill its intermediary function without eroding domestic money and credit policies. We support the consideration of both the need for and of means to promote this objective.

Under the circumstances, I believe it would be premature for the Congress to consider legislation directing the imposition of reserve requirements on Eurocurrency operations such as is proposed in HR 3962. In any event, as I understand it, the Federal Reserve would have all the authority it needed to take such action, should it later be found advisable to do so, upon Congressional approval of H.R. 7, the Monetary Control Act of 1979.

Finally, I am hopeful that today's hearings will prove useful in illuminating what is a very complex and technical aspect of international finance. We in the Executive Branch are continuing to examine these issues carefully in order to under-

stand them fully ourselves, and will be working to develop viable and useful solutions to such problems as may be disclosed during this examination. I look forward to continuing cooperation with the House Banking Committee throughout this process. These hearings are a good beginning.

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EXTRACT FROM
"THE OPERATION OF THE INTERNATIONAL MONETARY SYSTEM,
JULY 1977-MARCH 1979: A TREASURY ASSESSMENT"
(REVISED JULY 11, 1979)

The Financing of Payments Imbalances And Activity in International Capital Markets

INTRODUCTION

International money movements, if one includes all the short-term and foreign exchange transactions as well as medium and long term credit, are now in the range of tens of billions of dollars daily. These transactions occur for a variety of reasons and through a number of channels. There are no comprehensive reporting requirements which would provide data on the volume of transactions or their nature. The bulk of the transactions in terms of magnitude are very short term movements, and the flow is normally two-way. There is, in effect, an international money market. We do not have to add up all these transactions to reach conclusions about the way in which, on a net basis, they finance current account imbalances.

It is useful, however, to develop some estimates of the level of activity in medium and long term credit. There is a clear distinction between net balance of payments flows and a measure of activity. The net international capital inflow which "finances" the current account deficit of a country represents the balance of many transactions and is a much smaller magnitude than the volume of transactions. Moreover, the presentation of a balance of payments analysis cannot readily show such important questions as the extent of new borrowing which is necessary in order to repay maturing credits. A measure of activity of medium and long term flows can shed some light on this aspect and provide an indication of the institutional significance of credit markets--their strengths and potential weaknesses, and the impact of policy measures and supervisory practices--although it can be misinterpreted and lead to exaggerated views of the impact of international financial markets on real economic activity. This section looks at developments during the previous three years with a view toward assessing the relative role of the private credit markets and official credit flows in the functioning of the international financial system.

I. THE FINANCING OF PAYMENTS IMBALANCES

During the past three years countries with current account deficits have successfully sought to finance these deficits in large part from private sources, chiefly from banks. Indeed, the role of private banks

in intermediating large flows of funds from surplus to deficit countries is a hallmark of international monetary developments during the past five years. Funds provided by governments and by multilateral institutions, while increasing in 1978 in absolute terms, declined as a proportion of total financing extended during this period.

Nature of Capital Flows to Deficit Countries

Table 1 at the end of this section presents a very rough overview of the channels through which deficit countries as a group obtained the funds needed to finance their deficits. These financing patterns are shown separately in Tables 1-a through 1-d for four categories of countries: (a) OECD (i.e., largely the industrialized countries;) (b) OPEC; (c) non-oil exporting developing countries; and (d) other deficit countries. The U.S. is not treated as a deficit country for the purpose of these tables.*

As can be seen from these tables, deficit countries as a group have continued to rely primarily on the private markets for their net annual financing needs, the total of which has fluctuated in the range of $70-80 billion each year. Funds from official sources have been accounting for less than one-fourth of net financing required by all deficit countries. However, net official flows to developing countries have been proportionately much higher, ranging between 40% and 60% of their aggregate current account deficits. In 1978, there was a small increase in the amount of official flows to deficit countries as a group, accounted for entirely by flows to non-oil exporting developing countries.

In recent years, borrowing from banks has constituted the main channel of private finance to deficit countries although bond financing and other private investment flows have also been significant, particularly for OECD deficit countries. On average, the OECD deficit countries have been obtaining as much net financing through bond issues as from banks. Total liabilities of deficit countries to foreign banks have increased by considerably larger magnitudes, but claims of deficit countries on banks have also grown rapidly. Part of this growth on both sides of the balance sheet reflects the inflating effects of banks' redepositing of funds with other banks (which is a characteristic of the "Euro-currency" market).

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* Because of the extensive use of the U.S. money and capital markets and the international role of the dollar, inclusion of the U.S. would distort the presentation. A subsequent sub-section discusses U.S. capital account transactions.

The growth in lending through the private markets also reflects the emergence of sizable imbalances in the payments positions of surplus and deficit countries in the wake of significant oil price increases. A significant portion of the surpluses has been placed with private institutions, especially banks, and has been recycled to countries in deficit. This recycling role has contributed to -- and partly results from -- the efficiency of the Euromarkets, which are uninhibited by capital controls common to the domestic markets in many countries and not subject to reserve requirements imposed by national authorities on lending by resident banks in domestic currencies.

Pattern of U.S. Capital Movements

As shown in Table 2, United States residents provided considerable amounts of private capital to other countries despite large deficits in the U.S. balance of payments on current account in 1977 and 1978. Net banking outflows were particularly large in 1978 -- about $17 billion compared to $10 billion and $5 billion in 1976 and 1977 respectively. Gross outflows in 1978 reached $34 billion. The concentration of bank lending in the fourth quarter last year, followed by a partial reversal in early 1979, suggests that some of the banking movements were associated with exchange market disturbances and other transitory factors. Direct investment outflows have been increasing at a moderate pace and last year, on a net basis, were almost two-thirds as large as net outflows from U.S. banks. (Of the $15.4 billion in gross direct investment outflows, $10.7 billion represented reinvested earnings and $4.7 billion new funds from the U.S.) Compensating capital inflows to the U.S. largely took the form of increased official holdings of liquid dollar assets -- about $34 billion. There was also, however, a significant "inflow" from unrecorded transactions which is usually assumed to be largely the result of capital transactions not captured by the reporting system. The increase in foreign official assets reflected in large part intervention by other major countries which purchased dollars in the foreign exchange markets to stem the appreciation of their currencies. A number of other countries, however, appear to have been motivated by a desire to increase reserves.

The exchange market developments which so greatly affected the U.S. capital account in 1978 were themselves heavily affected by developments and expectations concerning fundamental economic performance in the U.S. and abroad. At times these factors more than offset the effect of differentials between U.S. and foreign short-term interest rates. Of course, the sheer volume of liquid funds held in national as well as the Euromarkets and the volume of international trade for which payments have to be made provide considerable scope for very large swings, especially in banking flows, in response to a wide range of specific factors.

The United States is almost unique in its capacity to provide large volumes of external finance, directly or indirectly, irrespective of its own balance of payments position. These outflows are, however, a product of many individual transactions reflecting *inter alia* the inability or unwillingness of other countries to perform these functions.

Role of the IMF

As the central monetary institution, the IMF is the principal source of official multilateral balance of payments financing. In a very real sense the Fund acts as the financial back-stop for the system. It serves as the lender of last resort for countries experiencing financial difficulties. The Fund also promotes the corrective measures required to achieve effective balance of payments adjustment.

The pattern of IMF financing shifted sharply during 1976-78. In 1976, net drawings by deficit countries (i.e., gross drawings, including reserve tranche, less repayments) amounted to a record $6.5 billion. The OECD countries accounted for about $4.3 billion, or 66 percent, of the total, and developing countries $2.2 billion (including $128 million by deficit OPEC members), or 34 percent. Drawings were heavily concentrated in the relatively less conditional facilities: the temporary Oil Facility and the liberalized Compensatory Financing Facility.

In 1977 and 1978 the use of IMF resources by deficit countries (excluding the U.S.) slowed considerably. In part this reflected the successful stabilization efforts of some countries -- both developed and developing - and the increased availability of financing from other sources. New drawings totalling about $2.9 billion in the two years were offset by repayments of outstanding drawings of roughly the same magnitude. However the area pattern of use of IMF resources shifted, with the developing countries having net drawings of $440 million in 1977-78 while the OECD had net repayments of about $460 million. In addition, drawings from the regular credit tranches were the predominant source of IMF financing.

II. ACTIVITY IN INTERNATIONAL CREDIT MARKETS

Amount and Types of Credit

Despite the relative stability in the size of aggregate current account deficits over the past three years, the volume of medium and long term credit raised in international markets during this period grew dramatically, as shown in Table 3. The increase in funds raised in these markets was especially large during 1978, particularly Eurocurrency credits.

A substantial portion of these loans did not create additional credit. The maturation of earlier debts contracted by borrowers required in many instances the seeking of new loans to "roll over" these debts. In addition,

conditions in the private markets in the past year have been favorable to borrowers, leading to widespread refinancing of unmatured debt in order to reduce interest costs and to lengthen maturities. Such debt repayments in 1978 are estimated to have accounted for over 40% of medium and long term Eurocurrency loans and over 20% of international bonds issued. Accordingly, the amount of net medium and long term credit extended through the Eurocurrency markets and the international bond markets has been considerably lower than gross new credit extensions in these markets.

Not included in these totals are loans extended to non-residents by banks in "domestic currencies", e.g., dollar loans by U.S. banks, DM loans by German banks. Much of such foreign lending from national markets serves to fund Eurocurrency loans syndicated internationally, and its addition to these loans would introduce double counting.

A major development over the past year or so has been the sharp increase in foreign borrowing in the German, Swiss and especially the Japanese bond markets. In 1978, foreign issues in these three markets increased by about 55% to $10.4 billion. Recourse to the Japanese market increased dramatically, as Japanese authorities adopted an increasingly liberal policy on foreign access to the Japanese capital market as a means of reducing pressure on the yen emanating from a strong current account position. In 1978, foreign bond issues in Japan more than tripled to $3.9 billion compared to only $1.2 billion the year before.

Size of the International Banking Market

Table 4 shows the main components of the liabilities of banks in major countries and "offshore" banking centers which serve to fund their net international lending of all types. The international banking market includes both transactions in the currency of the country in which the bank is located and transactions in other (i.e., foreign) currencies. The latter, e.g., borrowings and loans of dollars by banks in London, make up what is commonly known as the Eurocurrency market. The bulk of this market is denominated in dollars (Eurodollars), and since U.S. banks account for much of the transactions in domestic currencies, the predominant role of the dollar is evident. Indeed, almost all of the major form of Eurocurrency lending, the medium-term syndicated credit, takes place in dollars.

It is essential to recognize that measuring these markets by the gross amount of liabilities (or all external assets) is highly misleading. Almost half of the reported liabilities reflect the practice of redepositing of funds received with other banks in the reporting area, leading to "double counting" for which adjustments need to be made. These redeposits in turn reflect the high efficiency of the market in effecting rapid, extensive intermediation of funds between banks with excess supply of and

demand for funds, and arbitrage activities which eliminate disparities in interest rates and exchange rates in the various markets of the world. Eurocurrency liabilities to non-banks as of the end of 1978 were on the order of $165 billion.

Growth of International Banking Market in 1978

Growth of the international banking market in 1978 was quite rapid, and it accelerated sharply during the fourth quarter to a record annual percentage increase. A substantial part of the rapid growth is attributable to a statistical phenomenon. Liabilities (and assets) denominated in other currencies are reported in dollar terms. When the value of a particular currency rises in terms of the dollar in a particular period, the dollar value of the entire stock of assets and liabilities denominated in such a currency rises. In 1978, there were significant increases in both the dollar and the non-dollar segment of the market, quite apart from valuation changes. The increase in the latter was proportionately greater.

The increase reflected a number of different factors, the relative importance of which varied during this period. In addition to the U.S. current account deficit, foreign lending by banks in the U.S. was large by historical comparison. Substantial liquidity in the economies of major countries made it possible for banks in those countries, as well, to place funds in the Eurocurrency market. Other factors were increased tension in the exchange markets, which increased non-bank demand for financing changes in their pattern of trade payments, and the placement of funds in the market by official institutions.

Concerns Over the Eurodollar Market

The large magnitudes of dollar-denominated assets and liabilities arising from transactions in the Eurodollar market have led to expressions of concern by some observers that this market: (a) results in the extension of international credit in excessive amounts; (b) exposes the banks involved to an inappropriate degree of risk; and (c) increases the potential for speculation in the foreign exchange markets and adds to instability in those markets.

The dangers tend to be exaggerated and distract attention from the efficient functioning of the market and its very important role in facilitating the international extension of credit which was critical to avoidance of world economic disaster in the aftermath of the oil price increase in 1974. Neither national governments nor international institutions are in a position to play the primary role which this market now performs in international credit extension. Nevertheless, developments in the market need to be carefully monitored, and steps are being taken to improve our knowledge of and influence on this market.

Concern that credit extension is excessive may stem in part from focusing on the size of the market rather than the flows that it generates. The magnitudes of the net flows shown in Table 1., which include but are not limited to Eurodollar lending, are a more meaningful indicator of the role of the market in financing payments imbalances. Moreover, it is erroneous to think that Eurodollar transactions are carried on outside the jurisdiction of any supervisory authorities and are insensitive to instruments of domestic monetary policy. U.S. regulatory authorities have for some time been examining the global operations of U.S. banks both through their examination procedures at the home offices and through on-site examinations of most foreign offices. Demand and supply conditions in the market are influenced by interest rates which are linked to rates in the domestic market and thus to domestic monetary policy. With respect to international cooperation, steps taken by the governments and central banks of the major countries include expanding the collection of data on Eurocurrency transactions, limiting placement in the market by major countries of foreign exchange reserves, and increasing attention by bank regulators to the activities of foreign branches and subsidiaries of banks located in the major countries. While there may be room at the international level for improving regulatory techniques and strengthening the links to national credit markets -- the possibility of further improvements is under study -- international banking transactions can be said to be generally sound and to play a significant part in financing imbalances without undermining the adjustment process.

The Eurodollar market should not be viewed as being a unique causative factor in the weakness of the dollar last year, although the availability of dollar credit, whether from the Eurodollar or U.S. domestic market, provided one means of obtaining dollars to be sold for currencies that were expected to appreciate in the foreign exchange market.

TABLE 1
NET FINANCING BY DEFICIT COUNTRIES
$ Billions

All Deficit Countries, Excluding United States

	1976	1977	1978
FINANCING REQUIREMENTS	77	71	75
-- Aggregate Current Account Deficits 1/	72	65	68
-- Increase in Foreign Exchange Reserves 2/	5	6	7

* *

	1976	1977	1978
SOURCES OF FINANCING	85	74	82
Official Flows, Total	19	13	15
-- Multilateral Credits, Net	10	6	7
-- Net Use of IMF Credit	(6)	(0)	(0)
- Gross Drawings 6/	(8)	(1)	(2)
- Repurchases 6/	(1)	(1)	(2)
-- Net Flows from other Institutions	(5)	(6)	(7)
- Gross Credits	(6)	(7)	(8)
- Repayments	(1)	(1)	(1)
-- Bilateral Credits, Net of Repayments 7/	9	8	8
Private Flows, Total	66	61	67
-- Increase in Net Indebtedness to Banks in other Countries 3/ 5/	39	29	39
-- Increase in Gross Liabilities *	(82)	(75)	(92)
-- Increase in Gross Claims *	(42)	(46)	(53)
-- Bond Issues, Net	17	17	14
-- Gross Issues	(21)	(21)	(19)
-- Estimated Net Redemption	(4)	(4)	(5)
-- Net Direct and Non-Bank Portfolio Investments, and other flows 4/	10	15	14

* *

	1976	1977	1978
RESIDUAL:	8	3	7

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* includes inter-bank depositing

Treasury / OASIA
4-30-79

TABLE 1-a

NET FINANCING BY DEFICIT COUNTRIES
$ Billions

OECD Countries, Excluding United States

	1976	1977	197
FINANCING REQUIREMENTS	33	35	28
-- Aggregate Current Account Deficits 1/	37	33	23
-- Increase in Foreign Exchange Reserves 2/	- 4	2	5
* *			
SOURCES OF FINANCING	33	41	28
Official Flows, Total	3	0	0
-- Multilateral Credits, Net	3	0	0
-- Net Use of IMF Credit	(3)	(0)	([illegible]
- Gross Drawings 6/	(5)	(0)	([illegible]
- Repurchases 6/	(1)	(0)	([illegible]
-- Net Flows from other Institutions	(0)	(0)	([illegible]
- Gross Credits			
- Repayments			
-- Bilateral Credits, Net of Repayments	0	0	
Private Flows, Total	30	41	2[illegible]
-- Increase in Net Indebtedness to Banks in other Countries 3/	7	20	1[illegible]
-- Increase in Gross Liabilities *	(29)	(39)	(2[illegible]
-- Increase in Gross Claims *	(22)	(20)	(1[illegible]
-- Bond Issues, Net	15	14	1[illegible]
-- Gross Issues	(19)	(17)	(1[illegible]
-- Estimated Net Redemption	(4)	(3)	([illegible]
-- Net Direct and Non-Bank Portfolio Investments, and other flows 4/	8	7	[illegible]
* *			
RESIDUAL:	0	6	

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* includes inter-bank depositing

TABLE 1-b
NET FINANCING BY DEFICIT COUNTRIES
$ Billions

OPEC Countries

	1976	1977	1978
FINANCING REQUIREMENTS	2	4	9
-- Aggregate Current Account Deficits 1/	2	5	14
-- Increase in Foreign Exchange Reserves 2/	0	- 1	- 5
* * * * * * * * * *			
SOURCES OF FINANCING	2	2	6
Official Flows, Total	2	1	1
-- Multilateral Credits, Net	1	0	0
-- Net Use of IMF Credit	(0)	(0)	(0)
- Gross Drawings 6/	(0)	(0)	(0)
- Repurchases 6/	(0)	(0)	(0)
-- Net Flows from other Institutions	(1)	(0)	(0)
- Gross Credits	(1)	(0)	(0)
- Repayments	(0)	(0)	(0)
-- Bilateral Credits, Net of Repayments	1	1	1
Private Flows, Total	0	1	5
-- Increase in Net Indebtedness to Banks in other Countries 3/ 5/	1	1	3
-- Increase in Gross Liabilities *	(5)	(9)	(12)
-- Increase in Gross Claims *	(3)	(8)	(9)
-- Bond Issues, Net	0	0	2
-- Gross Issues	(0)	(0)	2
-- Estimated Net Redemption	(0)	(0)	(0)
-- Net Direct and Non-Bank Portfolio Investments, and other flows 4/	-1	0	0
* * * * * * * * * *			
RESIDUAL:	0	-2	-3

* includes inter-bank depositing

TABLE 1-c
NET FINANCING BY DEFICIT COUNTRIES
$ Billions

Non-Oil Exporting Developing Countries

	1976	1977	1978
FINANCING REQUIREMENTS	29	23	29
-- Aggregate Current Account Deficits 1/	22	18	22
-- Increase in Foreign Exchange Reserves 2/	7	5	7
* *			
SOURCES OF FINANCING	36	24	35
Official Flows, Total	13	11	13
-- Multilateral Credits, Net	6	5	7
-- Net Use of IMF Credit	(2)	(0)	(0)
- Gross Drawings 6/	(2)	(1)	(1)
- Repurchases 6/	(0)	(0)	(1)
-- Net Flows from other Institutions	(4)	(5)	(7
- Gross Credits	(5)	(6)	(7
- Repayments	(1)	(1)	(1
-- Bilateral Credits, Net of Repayments	7	6	6
Private Flows, Total	23	13	22
-- Increase in Net Indebtedness to Banks in other Countries 3/	19	4	15
-- Increase in Gross Liabilities *	(40)	(23)	(38)
-- Increase in Gross Claims *	(21)	(19)	(23)
-- Bond Issues, Net	1	2	2
-- Gross Issues	(1)	(3)	(3)
-- Estimated Net Redemption	(0)	(1)	(1)
-- Net Direct and Non-Bank Portfolio Investments, and other flows 4/	3	7	5
* *			
RESIDUAL:	7	1	6

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* includes inter-bank depositing

TABLE 1-d
NET FINANCING BY DEFICIT COUNTRIES
$ Billions

Other Countries

	1976	1977	1978
FINANCING REQUIREMENTS	13	9	10
-- Aggregate Current Account Deficits 1/	11	9	9
-- Increase in Foreign Exchange Reserves 2/	2	0	1
* *			
SOURCES OF FINANCING	13	6	12
Official Flows, Total	1	0	0
-- Multilateral Credits, Net	1	0	0
-- Net Use of IMF Credit	(1)	(0)	(0)
- Gross Drawings 6/	(0)	(0)	(0)
- Repurchases 6/	(0)	(0)	(0)
-- Net Flows from other Institutions	(0)	(0)	(0)
- Gross Credits	(0)	(0)	(0)
- Repayments	(0)	(0)	(0)
-- Bilateral Credits, Net of Repayments	0	0	0
Private Flows, Total	12	6	12
-- Increase in Net Indebtedness to Banks in other Countries 3/	12	4	11
-- Increase in Gross Liabilities *	(8)	(4)	(13)
-- Increase in Gross Claims *	(-4)	(-1)	(2)
-- Bond Issues, Net	0	1	1
-- Gross Issues	(1)	(1)	(1)
-- Estimated Net Redemption	(0)	(0)	(0)
-- Net Direct and Non-Bank Portfolio Investments, and other flows 4/	0	1	0
* *			
RESIDUAL:	0	-3	2

---

* includes inter-bank depositing

TABLE 1-e

1/ Balance of goods, services, and private and official transfers. Official transfers from OPEC countries are assumed to be entirely from surplus countries, and those to non-oil LDCs are assumed to be entirely to deficit countries. Non-oil LDCs may include some countries which, after receipt of official transfers, are in surplus on current account.

2/ As published in International Financial Statistics.

3/ Calculated from data reported to the Bank for International Settlements. Comprises increases in liabilities of residents of designated areas to reporting banks (i.e., increase in the banks' assets) less increases in their claims on those banks, excluding the estimated increase in that part of those claims representing foreign exchange reserves -- the latter are included in the "requirements" for funds. For 1978, data are available only through end-September and are extrapolated to obtain annual estimates.

4/ Very rough estimates based largely on direct investment transactions.

5/ Includes net borrowing by all Middle East oil exporters classified as "high absorbers", some of which are surplus countries (e.g., Iraq, Libya and, in 1976 and 1977, Iran).

6/ Not precisely comparable to IMF credit use/repayment. Drawings include reserve tranche purchases, but repurchases exclude drawings of the respective member's currency by other countries.

7/ Includes the following balance of payments financing provided by the U.S. to several countries:

1976: Italy drew and repaid $500 million under the swap facility with the Federal Reserve.

Mexico drew $1,175 million under various Federal Reserve and ESF credit facilities of which $300 million was outstanding at the end of the year.

United Kingdom drew and repaid $600 million, split evenly between the ESF and Federal Reserve, under swap facilities.

1977: Mexico repaid $300 million outstanding swap drawings to the ESF and Federal Reserve.

Portugal drew and repaid $300 million under credit facilities provided by the ESF.

1978: Portugal received $300 million in medium term balance of payments financing as part of a $750 million multilateral credit arrangement.

NOTE: Components may not add to totals due to rounding.

TABLE 2

BALANCE OF PAYMENTS FINANCING BY UNITED STATES
$ billions

	1976	1977	1978
ANCING REQUIREMENTS	46.8	49.6	73.2
-- Current Account Deficit	- 4.3	15.3	16.0
-- Increase in U.S. Reserve Assets	2.5	0.2	- 0.9
-- Increase in Other U.S. Government Assets	4.2	3.7	4.7
-- Bank Lending to Non-residents	21.4	11.4	34.0
-- U.S. Direct Investment Abroad	11.6	12.2	15.4
-- Purchase of Foreign Securities	8.9	5.4	3.4
-- Other Capital Outflows	2.5	1.4	0.6

* *

	1976	1977	1978
RCES OF FINANCE	37.5	50.5	61.6
-- Increase in Foreign Official Holdings of Assets in U.S.	18.1	37.1	34.0
-- Increase in Foreign Private Claims on U.S. Banks	11.0	6.7	16.9
-- Foreign Purchases of U.S. securities	4.1	3.4	5.1
-- Foreign Direct Investment in U.S.	4.3	3.3	5.6

* *

	1976	1977	1978
IDUAL	- 9.3	0.9	- 11.4

rce: Survey of Current Business, March 1979

Treasury/Economic Policy
4-30-79

TABLE 3

ACTIVITY IN MEDIUM AND LONG TERM INTERNATIONAL CREDIT MARKETS
$ billions

	1976	1977	1978
New Medium and Long-term Eurocurrency Bank Credits	29	34	72
— to Developed Countries	(8)	(11)	(30)
— to Oil Exporting Countries	(4)	(6)	(10)
-- to Other Developing Countries 1/	(17)	(17)	(32)
Less: Estimated Repayments and Refinancing	10	15	30
Net New Medium and Long Term Eurocurrency Bank Credits	19	19	42
International Bond Issues	34	36	37
— by Developed Countries	(23)	(23)	(23)
-- by Oil Exporting Countries	(0)	(1)	(2)
— by Other Developing Countries 1/	(11)	(12)	(12)
Le[illegible] Estimated Redemption	4	5	8
Net International Bond Credit	30	31	29

* *

	1976	1977	1978
TOTAL LENDING ACTIVITY IN INTERNATIONAL MARKETS	63	70	108
Less: Estimated Repayment and Refinancing	14	20	38
NET NEW MEDIUM AND LONG TERM LENDING IN INTERNATIONAL MARKETS	49	50	70

1/ Includes Eastern Europe and International Institutions.

Source: World Bank and Morgan Guaranty Trust Company.

Treasury/OASIA
6-25-79 (Revised)

TABLE 4

Main Components of Eurocurrency and International Banking Market

(Liabilities of U.S. and Euro-Banks) 1/

$ billions

* *

Liabilities To Non-Residents

		End 1978	INCREASE 1978
1.	Dollar Liabilities of Banks in Europe, Canada & Japan	398	80
	PLUS		
2.	Dollar Liabilities of U.S. Branches in Offshore Centers	101	16
	EQUALS		
3.	GROSS SIZE OF EURODOLLAR MARKET, FIRST DEFINITION	499	96
	PLUS		
4.	Other Foreign Currency Liabilities of U.S. and Euro-banks	174	47
	EQUALS		
5.	GROSS SIZE OF EUROCURRENCY MARKET, FIRST DEFINITION	673	143
	PLUS		
6.	Dollar Liabilities of Banks in U.S.	98	21
	PLUS		
7.	Domestic Currency Liabilities of Euro-banks	93	29
	EQUALS		
8.	GROSS SIZE OF INTERNATIONAL BANKING MARKET AS SHOWN BY BIS	864	193
	LESS		
	BIS Estimate of Double Counting due to Interbank Deposits Among Banks in BIS Reporting Area	334	93
10.	NET SIZE OF INTERNATIONAL BANKING MARKET AS SHOWN BY BIS	530	100

* *

Foreign Currency Liabilities To All Customers

		End 1978	INCREASE 1978
11.	Liabilities to Residents	170	37
12.	Of which: in dollars	125	23
13.	GROSS SIZE OF EUROCURRENCY MARKET, SECOND DEFINITION (Lines 5 and 11)	843	181
14.	GROSS SIZE OF EURODOLLAR MARKET, SECOND DEFINITION (Lines 3 and 12)	624	118

* *

ESTIMATED NET SIZE OF EURODOLLAR MARKET 350 to 400

1/ Consisting of banks in countries reporting to the Bank for International Settlements plus branches of U.S. banks located in the Bahamas, Cayman Islands, Hong Kong, Panama and Singapore.

Note: Partly Estimated

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5-30-79

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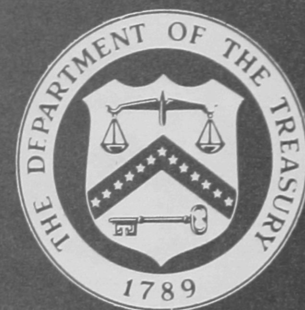

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July 12, 1979

WALTER J. MCDONALD IS SWORN IN
AS ASSISTANT SECRETARY FOR ADMINISTRATION

Walter J. McDonald, a career Federal executive, was sworn in today as Assistant Secretary for Administration by Treasury Secretary W. Michael Blumenthal. McDonald was nominated by President Carter on June 5, 1979, and confirmed by the Senate on June 27.

McDonald, who has been in the Treasury Department since 1964, was Acting Assistant Secretary (Administration) since November 1978. He succeeds William J. Beckham, Jr., who resigned.

From 1974 to 1978, McDonald was Deputy Director, Office of Management and Organization, where he shared responsibility for financial management, management analysis, emergency planning, personnel, and payroll/personnel information. He also directed a number of major studies of Treasury bureaus and operations.

During his 15-year career at Treasury, McDonald has also been Chief of the Emergency Planning Staff and a management analyst. He has received many awards for Government service, including the Civil Service Award for Distinguished Service, the Treasury Sustained Superior Performance Award (twice), and the Treasury Special Act or Service Award.

McDonald has a B.S. degree from New York University and a Master of Business and Public Administration degree from Southeastern University.

He and his wife, Sharon, live in Washington, D.C.

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partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE ON DELIVERY
July 12, 1979

STATEMENT OF THE HONORABLE RICHARD J. DAVIS
ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT & OPERATIONS)
BEFORE THE
SENATE ENERGY RESEARCH AND DEVELOPMENT
SUBCOMMITTEE
OF THE COMMITTEE ON ENERGY AND NATURAL RESOURCES
OF THE
UNITED STATES SENATE

Mr. Chairman, and members of the Subcommittee,

I appreciate the opportunity to appear here today to respond to certain questions relevant to your consideration of Title VIII of S. 1308 relating to the use of alcohol motor fuels. The questions you have raised, and to which I will address myself, involve the gasoline excise tax exemption, the applicability of the investment tax credits included in the 1978 Energy Tax Act, and the regulatory procedures of the Bureau of Alcohol, Tobacco and Firearms (ATF). I am accompanied by Mr. Thomas George, Chief, Regulations and Procedures Division, Bureau of Alcohol, Tobacco and Firearms and by Mr. John Copeland of the Office of Tax Policy.

Permanent Extension of Gasoline Tax Exemption

In a message sent to the Congress on June 20 the President recommended an extension of the exemption

for gasoline/alcohol mixtures ("gasohol") from the federal gasoline excise tax. This exemption was initially included in the Energy Tax Act of 1978 which exempted fuel containing a mixture of at least 10 percent alcohol from the four cents per gallon Federal excise tax on gasoline, but only through September 30, 1984. Under the Act the blend of gasoline and alcohol must consist of alcohol which is methanol or ethanol, but which does not include products of petroleum, natural gas, or coal.

Alcohol can be used as a petroleum supplement and octane booster which could help moderate current pressures on U.S. oil supplies. Since enactment of the four cents subsidy in 1978, gasohol sales in fact have risen rapidly. However, little interest has thus far been exhibited by commercial producers seeking to expand or build new commercial production facilities for gasohol. Development of these facilities, with the accompanying economics of scale, would help reduce the cost of producing gasohol in the future. Permanent extension of the gasohol exemption from the Federal gasoline tax, however, could significantly increase the incentive for production of this fuel by providing the continued demand for the product that new investors need. It is hoped, therefore, that this proposal will further assist in the development of our capability to produce gasohol.

The proposal will also make a technical change to existing law. The 1978 Energy Tax Act did not provide a mechanism for persons who pay the excise tax to claim a credit or refund of the excise tax paid if the gasoline is mixed with alcohol. The Technical Corrections Act of 1979 (H.R. 2797) contains such a provision. The Administration's proposal will make this technical correction in the event H.R. 2797 is not adopted.

<u>Energy Investment Tax Credit</u>

You have also requested that I discuss the applicability of the investment tax credit to gasohol production.

Section 301 of the 1978 Energy Tax Act provides for a 10 percent energy investment tax credit (in

addition to the regular 10 percent investment tax credit) for "alternative energy property." Alternative energy property includes "equipment for converting an alternate substance into a synthetic liquid, gaseous, or solid fuel (other than coke or coke gas)" and an "alternate substance" means "any substance other than oil and natural gas and any product of oil and natural gas." Thus, equipment for producing alcohol from a substance other than oil and natural gas and their derivatives would generally qualify for the energy investment tax credit provided, of course, that the alcohol produced is used as a fuel.

The additional 10 percent investment tax credit is available for acquisition of property after September 30, 1978, and before January 1, 1983.

ATF Regulatory Procedures

ATF has responsibility for assuring the collection of the excise tax on alcoholic beverages. Since, in 1978, this tax produced some $5.4 billion and involved a tax of $10.50 a proof gallon on distilled spirits, Congress has mandated and ATF has implemented numerous requirements to protect the revenue.

The system of regulations created by current statutes does not really consider the needs of those producing alcohol for use as fuel. It is for this reason that S. 1200, an Administration proposal introduced by Senator Bayh and 15 co-sponsors, would provide the Secretary with the authority to waive these regulatory requirements for those producing alcohol for mixture with gasoline, while allowing discretion to react to future developments or problems which may arise. This proposal, and our preliminary plan for implementing it, are discussed below. This legislation would particularly assist the small and middle size producers of gasohol, such as the farmer and farm cooperative. In the meantime, also as discussed below, ATF has been using the provisions for experimental distilleries temporarily to allow the development of gasohol facilities with the minimum burdens possible.

There are two types of distilled spirits plants (DSP's) presently authorized by law. The first is the commercial DSP -- this distiller is authorized to produce beverage or industrial alcohol. The second type of plant is the experimental DSP. This authorization is for any person who experiments or develops sources of materials for distillation, processes of distillation, or industrial uses of alcohol. The commercial DSP is authorized by section 5171 of the Internal Revenue Code. The Code requires that this type of plant be located on a commercial premises, have a continuous and closed distilling system, and provide adequate facilities for all operations, which may include production, warehousing, denaturation, and bottling. Extensive requirements also govern the location, construction, arrangement, and protection of the DSP.

In order to further protect revenue the distiller is required to give bonds to cover his potential tax liability. Bonds are required for production facilities and for storage facilities. The Government also is given a first lien on the distiller's plant. If the distiller does not own the property on which the plant is located he may also be required to file an indemnity bond in lieu of this lien.

While this system will be changed by the MTN implementing legislation, the commercial distiller's operations are under direct on-site supervision. ATF stations inspectors at DSP's to monitor all phases of production and storage. ATF literally maintains the distilling system and the alcohol under Government lock and key.

The present law also requires that, in order for alcohol to be removed from the DSP free of tax, it must first be denatured. "Denaturation" may be defined as the destruction of the beverage character of the alcohol, that is, it is rendered unfit for beverage use. Segregated facilities are required for the DSP proprietor to denature alcohol and only a DSP may denature alcohol. In addition, in the past the approved denaturation formulas have been limited. As discussed below, new formulas have been developed to ease the production of gasohol.

The commercial DSP also has substantial record-keeping requirements, which include many types of records detailing all production, storage, rectification, bottling, and other operations. Numerous reports and returns are required semi-monthly, monthly, and annually.

While ATF continuously evaluates its supervisory role and the purpose of the required records and reports, and attempts to regulate the alcohol industry with the minimum of intrusion, the regulatory scheme mandated by the Internal Revenue Code does not meet the needs of an alcohol fuel industry. The requirements for the commercial DSP are too extensive for many fuel producers, and prohibitive for the small and middle size producer.

The other type of plant presently authorized -- the experimental DSP -- provides only a temporary and extremely limited alternative. The experimental DSP is authorized to produce alcohol for experimental or developmental purposes only. No alcohol may be sold or given away. All alcohol produced must be used in experimental processes at the plant premises, with certain exceptions. This authorization, granted by Section 5312 of the Code, is intended for bona fide research and experiments. It is valid only for a limited period of time, generally two years. Due to these limitations, the experimental DSP is not subject to the extensive controls and requirements mandated for the commercial distillery. The experimental distiller has no on-site supervision and no required reports. This proprietor is, however, currently required to file a bond to cover his potential tax liability and is required to maintain records detailing his production and disposition of alcohol.

In 1978 there were 18 applications for experimental DSP authorizations. All of these applications were granted. Since January 1, 1979, ATF has received 2,042 applications for the experimental DSP -- all of these are fuel related, and most are individuals who want to produce fuel for their personal use. Although it is not actually clear that this use of the experimental DSP provisions were contemplated when this

legislation was enacted, ATF has moved to approve these applications under Section 5312, since there is no other provision for them under current law.

Approval of these applications is only a short term and unsatisfactory solution for those who are seeking alternative fuels, however. These plants may not produce fuel alcohol for sale, their authorization is for a limited period of time, and many of those who have made this application have experienced difficulty in obtaining the requisite surety bond. The lack of clear statutory authority and of established guidelines regulating these plants also creates the kind of confused situation which produces the risk of diversion of this alcohol to the beverage market.

ATF has waived all regulatory requirements within its waiver authority. The one remaining area where further relief is possible relates to the bond requirement. ATF has tentatively approved approximately 95 percent of the nearly 2100 applications, yet only 113 have been authorized to operate -- the Bureau cannot issue an authorization without an approved bond. ATF has determined that it can waive the bond requirement for experimental DSP's without undue risk to the revenue and a final rule is being prepared to do so. The experimental DSP procedures remain, however, stop-gap at best.

The proposed legislation -- S. 1200 -- now before the Congress will provide the Department with the flexibility required to meet the needs of the alcohol fuel industry. This legislation provides for a third type of DSP -- the fuel producer. This bill authorizes the establishment of plants which may produce alcohol for fuel purposes only. The distiller may remove the alcohol free of tax after rendering it unfit for beverage purposes. This legislation would give the Secretary broad authority to waive existing regulatory requirements for these new types of plants. We have also attached to the legislation a paper describing how, subject to Congressional and public comment, we plan to implement this statute, if passed. I would like to submit a copy of this plan for the

record. Our plan necessarily, however, might change over time. Based on our experience, we may discover that further liberalization is possible. At the same time, it must be recognized that our proposals do increase the risk of illegal "moonshining" and, if problems develop, regulatory action to deal with that problem may have to be taken.

We envision a regulatory scheme which provides for intrusion only to the degree necessary to protect the revenue. Under the proposed plan, the fuel producer plants would be regulated in direct proportion to the danger they present to the revenue, based on their production. We propose to establish three categories of alcohol fuel producers -- the small, medium, and large alcohol fuel distiller. A small producer would be one who makes up to 5,000 proof gallons per year; the medium producer would produce from 5,000 to 100,000 proof gallons per year; and the large producer would produce in excess of 100,000 proof gallons per year. A proof gallon is one liquid gallon of 100 proof alcohol.

While specific regulatory controls will vary at each level of production, all fuel alcohol plants will be expected to file a simplified application; denature their alcohol; maintain some security necessary to prevent diversion of alcohol to uses other than fuel; and maintain limited records with respect to production and disposition of the alcohol. The small producer would not be required to file a bond; but the medium and large producers would be required to give a surety bond.

One planned reform is to simplify the application procedure. While the present commercial distiller may be required to file as many as twenty different forms and additional documentation, such as detailed drawings and plans of the distillery, the fuel producers will be required to file only one basic form -- the application. The large producer would also be required to file certain other forms giving more details about the plant's operations, facilities, equipment and business structure.

At the present time all distillers who also store alcohol must give a surety bond with the minimum penal sum of at least $10,000 up to a maximum penal sum of $200,000. The bond is calculated on the potential tax liability for alcohol produced and stored during any 15 consecutive days under our plan. The small fuel producer would not be required to file a bond. The medium and large producers will be required to give a bond in order to mimimize the risk to the Government of any loss of tax revenue and to protect the plant itself from tax liability on any alcohol diverted unlawfully to nonfuel purposes.

The law now also requires every distiller to have a continuous and closed system. A closed distilling system may be described as one in which the alcohol can be removed only at one point. ATF can thereby assure that all production is then properly accounted for.

Under our proposal the small producer need not have a closed distilling system, but need only be able to accurately determine the proof and quantity of his production and to store the alcohol in a secure storage facility. The basic equipment necessary to determine the proof of the alcohol is not expensive nor sophisticated.

The medium producer would similarly be required to be able to gauge his production, again with inexpensive and simple equipment. The medium producer would only be required to have a closed system in the instance of a plant operated by a number of individuals, for example, a farm cooperative. The medium producer who is required to have a closed system would, however, use his own seals and locks. This producer would also be required to have a storage facility which he can lock. No additional security measures would be required.

The large producer will be required to have a continuous and closed system and ATF will maintain security with Government locks and seals or by meters installed by the proprietor. If the MTN implementing legislation is adopted, this requirement will be eliminated for these producers as well.

The proposed requirements for construction are comparable to the present requirements for commercial distillers only in the case of the large producer. The small and medium producers have substantially less restrictive requirements due to their significantly smaller volume of production.

The present commercial distiller is required to provide substantial security for the distilling system and the alcohol. The security measures which the fuel producers may be required to provide are only those necessary to prevent theft or unauthorized removal of alcohol. It is possible that the small and medium producers will not be required to implement any security measures beyond those which they might already deem necessary simply to protect their property.

The present commercial distiller is also now required to file numerous reports and returns and to make numerous records. Under our plan the small producer will be expected to maintain a record only of the quantity and proof of the alcohol produced; the quantities and types of materials added to the alcohol to destroy the beverage character; and, of the disposition of the denatured alcohol. Once a year, the small producer will file a report with ATF stating the volume and proof of alcohol produced annually and the disposition of the denatured alcohol.

The medium producer will be expected to maintain records of volume and proof of alcohol produced; the quantities and types of materials used to destroy the beverage character of the alcohol; and, the disposition of the alcohol. This producer will be expected to file a semi-annual report with ATF giving the details of production on a monthly basis and of the disposition of its alcohol fuels.

The large producer will be expected to maintain records of volume and proof of alcohol produced; the quantities and types of materials used for denaturation; and the disposition of its denaturated alcohol. Additionally, the large producer would be expected to maintain records of the materials received and used to produce alcohol. The large

producer will file a quarterly report providing details of the volume and proof of alcohol produced by months and of its disposition.

Present commercial distillers are required to denature alcohol using specified formulas requiring substances such as gasoline, kerosene, and other chemicals. At the present time denaturation must be accomplished either under the direct supervision of ATF inspectors or through metered systems. ATF will work with the fuel producer to develop an acceptable formula which will meet his specific needs. For example, we now plan to authorize the denaturing of alcohol by using as little as ten gallons of gasoline for every 100 gallons of alcohol. This should provide substantial assistance to the gasohol producer.

We believe that the changes in the law which have been presented in our proposal will then provide the Bureau and the Government with the flexibility to be responsive to the varying demands and considerations for fuel producers, both big and small -- from the commercial plant which produces millions of gallons annually, to the home producer who makes only enough fuel to run his farm or heat his home. We have articulated a plan to implement this legislation. We welcome any further suggestions to improve it. We hope to respond to the needs of today with a program which will protect the revenue while easing the burdens and obstacles which the fuel producer faces. While we are now utilizing stop-gap, interim measures to provide for immediate authorizations for fuel producers, if S. 1200 is adopted it would remove the obstacles which prevent maximum alcohol production and would allow the alcohol fuel producers to make the maximum contribution to the American people with the minimum regulation.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions which the Committee may wish to ask.

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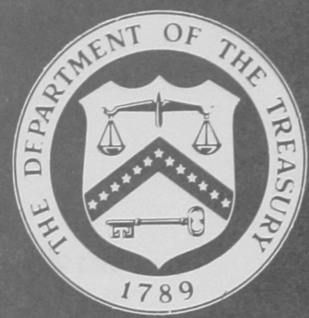


FOR RELEASE AT 4:00 P.M. July 12, 1979

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $3,380 million, of 364-day Treasury bills to be dated July 24, 1979, and to mature July 22, 1980 (CUSIP No. 912793 4M 5). This issue will not provide new cash for the Treasury as the maturing issue is outstanding in the amount of $3,380 million.

The bills will be issued for cash and in exchange for Treasury bills maturing July 24, 1979. The public holds $2,153 million of the maturing issue and $1,227 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, July 18, 1979. Form PD 4632-1 should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders, the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

B-1720

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. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. 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. 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, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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.

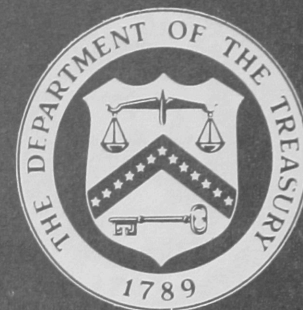
Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in 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 July 24, 1979, in cash or other immediately available funds or in Treasury bills maturing July 24, 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 NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041



FOR IMMEDIATE RELEASE
July 12, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY ANNOUNCES FINAL DETERMINATIONS
IN COUNTERVAILING DUTY INVESTIGATION
ON CERTAIN TEXTILES AND TEXTILE PRODUCTS
FROM THREE COUNTRIES

The Treasury Department today announced its final determination not to impose countervailing duties on imports of certain textiles and apparel from Malaysia and Mexico. A final determination that Pakistan is subsidizing exports of these products was also announced.

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.

Treasury's investigation determined that the benefits were provided by the Governments of Malaysia and Mexico to their respective textile and apparel firms, but the size of these benefits were too insignificant to warrant the imposition of countervailing duties. Mexican subsidy programs comprised preferential export financing and duty-free machinery imports. Malaysian subsidies included tax exemptions for companies surpassing their previous year's export sales level.

In the case of Malaysia, one company was found to receive a countervailable benefit, but that firm has agreed to pay voluntarily to its government an amount equal to the subsidy received. Accordingly, no countervailing duties will be imposed.

In the Pakistan case, Treasury found that the textile exporters received subsidies consisting of: (1) Partial reductions in total income tax liabilities for firms which export; and (2) short-term export financing at preferential rates.

In Pakistan, the ad valorem amount of subsidy was determined to vary among the products subject to the investigation, with the largest subsidy estimated to be 1 percent ad valorem on exports of cotton garments. On the other hand, the subsidy paid on towels was insignificant in size, and therefore no countervailing duties will be imposed on exports of towels from Pakistan.

-MORE-

Imports of certain textiles and apparel in 1977 from Malaysia were valued at $22.2 million and from Mexico at $101 million. Imports of this merchandise from Pakistan in 1978 were valued at $42 million.

Notices of these findings will appear in the Federal Register of July 13, 1979.

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FOR RELEASE ON DELIVERY
July 11, 1979

STATEMENT OF THE HONORABLE RICHARD J. DAVIS
ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT & OPERATIONS)
BEFORE THE
SUBCOMMITTEE ON TREASURY, POSTAL SERVICE,
GENERAL GOVERNMENT
OF THE
SENATE APPROPRIATIONS COMMITTEE

Mr. Chairman and members of the Subcommittee,

I appreciate the opportunity to appear here at these oversight hearings today to discuss with you various aspects of the operations of the Bureau of Alcohol, Tobacco and Firearms. Accompanying me is Mr. G. R. Dickerson who is the Director of the Bureau and members of his staff.

As the Assistant Secretary for Enforcement and Operations, I have oversight and general supervisory responsibility for five Treasury entities which have enforcement responsibilities. They are the U.S. Customs Service; the U.S. Secret Service; the Office of Foreign Assets Control, the Federal Law Enforcement Training Center and the Bureau of Alcohol, Tobacco and Firearms. I also am responsible for coordinating law enforcement policy for all Treasury Department matters.

As part of my responsibilities, I am necessarily concerned with the agency priority setting process, methods and practices of operations and, of course, allegations of misconduct and government abuse. I wish to discuss very broadly certain policies of the Treasury Department which are relevant to these hearings and to the activities of the Bureau of Alcohol, Tobacco and Firearms. I will leave to Mr. Dickerson a more specific discussion of the various activities of the BATF.

One area about which you have expressed interest is the question of alleged investigative abuses by BATF. In this regard I think it is important to remember that criminal investigations and enforcement are by nature conflict-oriented. Inevitably, any criminal investigation situation is bound to produce negative reaction from the subjects of investigations. This is often the case regardless of guilt or innocence. It is simply not the kind of activity which by its nature creates good feeling among the parties involved.

Rigorous enforcement of violations of the criminal laws is necessary for the effective functioning of any agency with criminal enforcement responsibility. Though it may be a necessary ingredient to effective accomplishment of an agency's mission, it can sometimes lead to instances of abuse or misconduct on the part of the investigator. At the same time criminal investigations, by their nature, also can produce false allegations by the subject of an investigation of misconduct or other wrongdoing.

While instances of abuse and bad judgment are unfortunately inevitable in any organization, there are steps which can be taken to minimize their occurrence. One such step is the development of a strong internal affairs division. Such a division is a valuable management tool for an agency as it enables it to investigate allegations of improper conduct. It also serves to protect the public. At the same time, from an agents viewpoint it is also quite desirable as it protects him/her from unfair or unfounded accusations.

Great emphasis has been placed on the internal affairs function within each Treasury enforcement bureau. The Office of the Inspector General was also created last fall within the Office of the Secretary of the Treasury. It has an effective oversight function for all internal affairs activities within the Department. At the same time we have been working with Director Dickerson since he took office to enhance BATF's capabilities in this area.

It is important also to make certain we are aware of instances of improper or questionable conduct by our agents. To help accomplish this some time ago I sent a letter to the Department of Justice and asked them to notify the relevant Special Agent-in-charge of any Treasury law enforcement agency whenever in the course of a judicial proceeding a motion to suppress is granted on account of the action of that agency's agent or when the court finds that one of our agents committed an illegal or otherwise improper act. This would enable agencies to identify not only single incidents, but any patterns of conduct requiring policy change or discipline.

Another way to avoid instances of misconduct is to develop management policies dealing with sensitive areas. As you know, last fall BATF and Treasury re-evaluated and subsequently changed procedures governing routine compliance inspections of firearms licensees and investigations of gun shows. Except for a small number of situations, BATF has ceased to make unannounced inspections of licensees. In most cases licensees are phoned to be notified of a proposed inspection. Inspections without prior notification are now generally limited to very specific instances where there is reason to suspect a violation based on the licensee's prior conduct or where there is specific information indicating that a licensee may not be in compliance.

BATF has also limited its investigations of gun shows and flea markets to situations where there are specific allegations that significant violations have occurred and where there is reliable information that guns sold at the specific show or flea market have shown up in crimes of violence with some degree of regularity. Mr. Dickerson will elaborate more on this issue in his testimony.

With regard to undercover operations, we have stressed the need to ensure that proper steps are taken so that undercover operations are not directed at anyone unless there is reliable information that the person has committed serious violations in the past or is about to commit one in the future. Also when an individual who is the subject of an undercover investigation indicates a lack of desire to make an illegal sale it is our policy that no informant or agent coax or otherwise encourages him to do so. We have also created a Treasury-wide task force to review all policies regarding undercover investigations.

These then are some of the steps we are taking to try to ensure proper conduct by our agents in enforcing the law. Director Dickerson will describe other changes made to try to direct BATF resources to the most serious problems in the firearms and other areas. I can assure you that we constantly strive for the highest possible standards of performance and conduct from our personnel. In the vast majority of cases we have achieved this. A critical examination of the record of BATF will reveal an overwhelming number of successful investigations and criminal prosecutions. But as with any organization there is always room for improvement and certain acts occur of which we do not approve. Every effort is presently being made to eliminate these incidents to the extent possible.

Thank you, Mr. Chairman.

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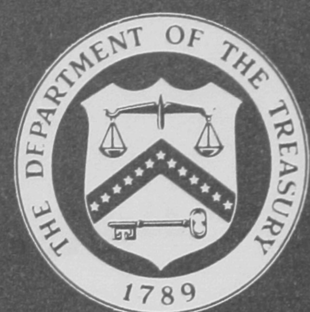

FOR RELEASE ON DELIVERY
Expected 10:00 AM
July 11, 1979

TESTIMONY OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
JOINT ECONOMIC COMMITTEE

Mr. Chairman, you have asked for a report on the Tokyo Summit.

The Summit has received wide coverage in the press. I am sure that you and your colleagues and your staffs have reviewed these reports and the communique that was issued by the participating countries. If you will allow me, I prefer to concentrate my remarks not on the specifics of the Summit meeting itself, but on its broader meaning and significance, which I view as substantial. During the question and answer period I shall be glad to address myself to specific issues you wish to have clarified.

The Tokyo meeting was a watershed in Summit history. At previous Summits -- at Rambouillet, Puerto Rico, London and Bonn -- the focus of the deliberations was on demand management, specifically the need for greater coordination of demand management policies. The object was to reduce tensions in the economic and monetary systems by agreeing to pursue policies which corrected divergent growth and inflation patterns in individual countries. In effect,

though each of these Summits played a valuable role in enhancing macro-economic coordination and dealt with the question of enhancing global energy production through World Bank lending to the less developed countries, it would be fair to say that the meetings that preceeded Tokyo did not grapple head-on with the root causes of the world's energy and structural crises.

At Rambouillet in 1975 the primary focus was on stimulating recovery from the 1973-74 global recession through coordinated demand policies and improved international monetary arrangements.

At Puerto Rico in 1976, the discussion centered on managing the transition from recovery to expansion, again through traditional demand management techniques.

At London in 1977, the Summit participants sought to continue the expansion through a coordinated effort in which countries with balance of payments surpluses were encouraged to grow more rapidly and deficit countries more slowly.

The Bonn Summit last year continued the discussion of coordinated growth scenarios and, Mr. Chairman, I am sure you will remember that it was at this Summit that pledges were made to implement short term policies to achieve specific growth rates. Thus on the one hand the thrust of the three previous Summits reached the height of refinement at Bonn. Specific ways were detailed on reaching coordinated demand

management and were then successfully pursued. In the aftermath of Bonn, growth among the Summit countries became less divergent and consequently payments imbalances narrowed. For this we should be grateful; the commitments made at Bonn and adhered to especially by Japan, Germany and the United States were critical factors in reducing serious tensions in the global payments and financial systems.

But the significance of Bonn goes beyond this achievement. At the Bonn Summit there became evident an awareness of the limited usefulness of demand management in addressing not just the symptoms but the causes of the constrained potential growth and of the inflation, payments imbalances and monetary instability that is plaguing the industrialized and the developing worlds. The Communique issued at Bonn acknowledged that "we are dealing with long term problems which will only yield to sustained effort...there must be a readiness over time to accept and facilitate structural change. Measures to prevent such change perpetuate economic inefficiency, place the burden of structural change on trading partners and inhibit the integration of developing countries into the world economy."

It was at Tokyo that this awareness crystalized. At Tokyo we jointly acknowledged the shortcomings of demand management as a cure to our common economic malaise. The emphasis at Tokyo was on the need for structural adjustment and not fine tuning. We acknowledged that unless we were

to permanently forgo growth, jobs and a perpetually rising standard of living, the emphasis of macro-
economic management must shift to increasing directly the supply of energy and other goods.

Let me elaborate.

The immediate problem faced at Tokyo was the energy problem. With the announcement of the pricing decision made by OPEC in Geneva, the world price of oil has gone up by 60 percent since December. Although the price increases have come in stages, we have not yet seen more than a small fraction of the effect in the performance statistics. The direct, first round effect of this price increase will be to cut one percent from the average OECD growth rate in 1979, and 1-3/4 percent in 1980. It will add 1-1½ percent to the average OECD inflation rate in 1979, and 2-2½ percent in 1980. For the U.S. alone, it will cut one percent from our growth rate, and add one percent to our inflation rate, in each year. And these estimates may not fully capture the impact of continued oil price escalation and supply uncertainty on business confidence, consumer behavior and wage demands.

Thus:

-- The likelihood of recession in the United States has been increased.

-- Non-inflationary growth in the other industrialized countries has been seriously hampered.

-- Severe damage may be done to the economies and political structures of the less developed countries.

The oil price increase will reverse much of the progress that had been made in improving the world balance of payments. However, even with a higher oil import bill, we expect further substantial reductions in the U.S. current account deficit -- perhaps even a small surplus next year -- because of slower growth in our domestic economy extremely strong export performance, and increased earnings on our overseas investments. But the OPEC surplus, which had nearly disappeared last year, will again surge to disturbingly high levels. The OECD countries as a group will move from surplus into deficit. And the position of the non-oil developing countries, already in large deficit as a group, will deteriorate sharply, increasing the problems of some of the poorest nations.

World financing needs have been increased sharply by the oil price increase. Although the international monetary system has demonstrated its capacity to handle those needs in the aggregate, we must expect a recurrence of strains and difficulties on the part of some individual countries, noteably the LDC's.

In short, the world has again been thrown into a difficult situation by oil price increases. And today we not only have the problem of oil price increases but also of limited supply.

The Tokyo Summit recognized this essential fact, and acted upon it.

First, it was agreed that there is no alternative to conservation in the short-run. If we do not deliberately reduce our consumption of oil in ways that

are least damaging to our economy, consumption cutbacks will be forced -- capriciously and painfully - by whatever increase in price it takes to reduce demand to the level of supply.

To bring this situation under better control, the Summit nations each committed themselves to limits on oil imports in 1979 and 1980, limits that will apply on a country-by-country basis. The limit for the United States is 8.5 million barrels a day in both years -- equivalent to our imports in 1977.

For the medium-term, the Summit countries adopted specific goals for a ceiling on oil imports in 1985, goals which -- assuming reasonable rates of economic growth over the period -- will require very powerful efforts to conserve oil consumption and develop alternative sources of energy.

-- The U.S. goal for 1985 is the same as for 1979 and 1980, 8.5 million barrels per day.

-- France, Germany, Italy and the United Kingdom committed themselves to limiting 1985 oil imports to 1978 levels and agreed to recommend to their European Community partners that each EC member country pledge themselves to similar specific targets.

-- Canada pledged to reduce its annual rate of growth of oil consumption to one percent, and to reduce oil imports by 50,000 barrels per day by 1985.

-- Japan adopted as a 1985 target an oil import level of 6.3 to 6.9 million barrels a day, a level substantially higher than Japan's import level of 5.0 mbd for 1978. This allowance for increase will allow Japan to continue to pursue the high rates of growth needed to overcome the massive, fundamental imbalances in its external accounts. At the same time it will mean an increase in the efficiency with which the Japanese use imported oil. Recognizing the uniqueness of this commitment, Prime Minister Ohira pledged to do the utmost to further reduce oil imports and rationalize oil usage.

Meeting these goals will require tremendous efforts of conservation. But to meet these goals and improve upon them in the future will also require a massive effort to increase the supply of alternative energy resources. To this end the Summit participants launched major initiatives to make use of alternative energy sources, particularly coal, and to develop alternative sources and techniques. The participants recognized that large private and public resources will be needed for the development and commercial application of new technologies, and committed themselves to ensuring that those resources are made available. They also agreed to create an international energy technology group to review actions taken or planned in each country and to report on the need and potential for international collaboration, including in the area of financing.

For the longer run we must mobilize the resources needed to develop secure alternative supplies. The investment costs will be enormous, and resources must be diverted from consumption and other uses for this purpose. This will require an all-out effort to increase the use of other existing sources of energy, such as coal and nuclear power and natural gas, as well as the development of new technologies.

These Summit actions represent a basic reorientation of policy, a joint dedication to reduce dependence on oil. Implementing these commitments will not be easy, and we cannot expect the underlying situation to improve overnight. What is implied is a basic restructuring of our economies, and we will have to persevere through some difficult times. The specifics of what will be needed are under review, and we and other participating governments will be announcing detailed measures in the weeks ahead. But the direction and the commitment have been firmly established. I believe this commitment has been recognized by at least some of the major OPEC nations, and I am pleased that Saudi Arabia has indicated a production increase that can help to ease the situation in the immediate future. But this step, while helpful, is temporary. We must reduce our dependence on oil. We have set a course, and we have to stick to it.

Mr. Chairman, I have reviewed the actions taken at Tokyo to deal with a critical commodity that is and will continue to be in short supply. Energy is symptomatic -- in the extreme -- of a larger problem also noted in the Summit communique, and I would like to outline briefly that broader context.

It was recognized at the Summit that energy is not the only supply problem we must address. In many other respects, the economies of the industrial world are not responding as they must to changing conditions. For decades we have operated on a consensus -- that the major economic policy concern of governments should be to manage aggregate demand to smooth out swings in the business cycle and assure steady increases in income and employment. The supply side of the equation was largely neglected, assumed to take care of itself and respond to changing demands.

This assumption no longer holds. The supply side is not responding. Productivity is lagging badly -- in the U.S., productivity growth in the past five years has been only about half what it was in the 1950's and 1960's. Government spending has taken an ever growing share of income, and has shifted away from capital construction and defense toward income transfers. Effective tax rates have escalated sharply. Tax structures and levels are such as to stultify innovation and risk taking. Industry is bound in a stifling web of regulations. Indexation, formal and informal, tends to fix relative prices and weaken incentives for movement of resources between industries and sectors.

We need, in short, to reorient economic policy to concentrate more heavily on the supply side, to reduce rigidities and inefficiencies that create supply constraints throughout the economy. This task involves rebuilding our capital stock, reinvigorating productivity growth, reducing structural unemployment -- all on top of creating a new base for the energy needs of the economy.

This is true in part for every Summit country. Let me quote from the Tokyo communique:

"We agree that we must do more to improve the long-term productive efficiency and flexibility of our economies. The measures needed may include more stimulus for investment and for research and development; steps to make it easier for capital and labor to move from declining to new industries; regulatory policies which avoid unnecessary impediments to investment and productivity, reduced growth in some public sector current expenditures, and removal of impediments to the international flow of trade and capital."

Each of these tasks will take a long time to accomplish and will involve a great deal of sacrifice. Together, they represent a fundamental political and economic challenge. The politician's job is inherently easier -- and safer -- when it consists of spending heavily on quick pay-out projects that please the voters. This is as true in the United States as it is in Germany or Japan or France, Canada, England or Italy. But the time required to earn a visible return on investments made in expanding supply is much longer than the horizon that defines

the political calendar in any Summit country. The question is whether we have the will, wisdom and discipline to stay a medium-term course, involving short-term sacrifices for longer-term gains. We are all aware of the difficulty involved in this effort. But we are confident that, in the end, the American people and our allies at the Summit table will have the strength and patience to do the job.

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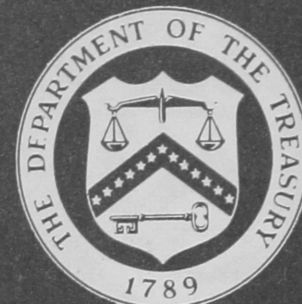

FOR IMMEDIATE RELEASE
July 12, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY DEPARTMENT WITHHOLDS APPRAISEMENT
OF SPUN ACRYLIC YARN FROM JAPAN

The Treasury Department said today it is withholding appraisement on imports of spun acrylic yarn from Japan. The withholding action, based on a tentative determination that this product is being sold in the United States at "less than fair value," will not exceed six months. A final determination will be issued in three months.

Under the Antidumping Act, the Secretary of the Treasury is required to withhold appraisement when he has reason to believe or suspect that sales at less than fair value are taking place. Sales at less than fair value generally occur when imported merchandise is sold in the United States for less than in the home market or to third countries.

Withholding of appraisement means that the valuation for Customs duty purposes of goods imported after the date of the tentative determination is suspended until completion of the investigation. This is to permit assessment of any dumping duties that are ultimately imposed on those imports.

Cases in which a final determination of sales at less than fair value is issued are referred to the U.S. International Trade Commission to determine whether an American industry is being, or is likely to be, injured by such sales. Both sales at less than fair value and injury must be found to exist before a dumping finding is reached.

Notices of this action will appear in the Federal Register of July 13, 1979.

Imports of spun acrylic yarn from Japan during 1978 were valued at $4.6 million.

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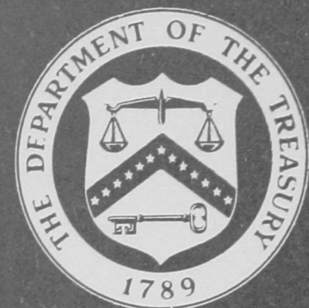

FOR RELEASE UPON DELIVERY
EXPECTED AT 10:00 A.M.
FRIDAY, JULY 13, 1979

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

Mr. Chairman and members of this distinguished Committee:

Your letter of invitation for these hearings asked me to comment on an exceptionally wide range of economic and policy issues. I have tried to address most of them in my prepared testimony, and will be most happy to supplement the testimony in our colloquy this morning.

I believe that the questions you pose can be grouped under the two critical issues facing the nation: inflation and energy. These problems are interrelated, and their solutions are interdependent. We cannot reduce inflation without resolving energy supply problems. Unless we master the inflation problem, the prospect of a mild downturn of short duration could turn into the much grimmer prospect of a deeper, more prolonged recession. And we cannot solve either the energy or the inflation problem unless we are willing to make the sacrifices--individually, collectively and equitably--that are necessary to insure our economic future.

Inflation. Our core problem is inflation--inflation that is decimating the purchasing power of American consumers, inhibiting business investment, weakening our export competitiveness.

Since last December, consumer prices have risen at a 13-1/2 percent annual rate, a sharp acceleration from the 9 percent of last year, and almost double the inflation rate in 1977.

Earlier in the year, a major element in the inflation was the rise in food prices, as adverse weather conditions

and strikes pushed the food component of the Consumer Price Index to a 20 percent annual rate of increase. But increasingly, the thrust to inflation has come from rising energy prices. The food supply situation has improved, and the rate of increase in food prices at retail has slowed--although retail prices have not yet reflected the actual declines in food prices at the wholesale level.

But while the rise in food prices has decelerated, the increase in energy prices has accelerated, as the increases in crude oil prices levied by the OPEC nations last December and additional surcharges added by most oil producing nations began to permeate the price structure. In January and February, some 30 percent of the increase in consumer prices resulted from the rise in food prices, and only 10 percent was attributable to increased energy costs. By May, the proportions were reversed, with just over one-tenth of the May rise in consumer prices the result of higher food prices, and about one-third of the total reflecting increases in energy prices. Since the beginning of the year, energy product prices at retail have gone up at almost a 38 percent annual rate, more than three times faster than the rest of the items bought by consumers.

Moreover, these figures measure only the direct increase in energy product prices--the rise in gas, electricity, gasoline and heating oil prices. But rising energy costs affect prices of all other goods. Very sharp increases have been registered in the past few months across a variety of petroleum-based chemicals, and these will show up in finished goods prices later on, as will the higher costs of transportation engendered by rising energy prices.

It is important to recognize the extent to which the inflation that has plagued us this year has stemmed from forces not directly related to current levels of domestic demands but rather has reflected forces which were unpredictable and over which we have had no control. The persistence of double-digit inflation despite the gradual and now clear slowing in economic activity has been interpreted by some as a measure of the failure of the Administration's efforts to move toward price stability through a voluntary program dependent essentially on the cooperation of business and labor. From this assessment of failure, some have argued for abandonment of the program, others have argued that the voluntary program should be supplanted by mandatory controls.

But such glib and premature conclusions do not stand up to a more careful analysis of the price statistics. Approximately half the composition of the Consumer Price Index is accounted for by three categories: food, energy, homeownership costs. For one or another reason, these areas are not within the effective scope of the wage/price deceleration program--nor, for that matter, would they be any more amenable to control under a mandatory system. But the major price acceleration this year has been in just these areas. Prices of food, energy and home-ownership combined have increased this year at a 20 percent annual rate, up from 11 percent last year. The rest of the CPI has accelerated too--not decelerated, as we had hoped--but the acceleration has been quite modest, from 6.7 percent last year to a 7.0 percent rate in the first five months of 1979.

On the wage side of the program, the publicity attendant on several major collective bargaining settlements that were judged to be outside the guidelines in varying degree has led to similarly premature conclusions about the failure of the deceleration program. But the most reliable measure of changes in wages--the BLS series on average hourly earnings for production workers--has increased thus far this year at an annual rate of under 8 percent, compared with an 8.5 percent increase during 1978. Wage increases have _not_ been a primary cause of accelerating inflation.

Nevertheless, unit labor costs have accelerated sharply. This apparent anomaly reflects in part the acceleration in private and publicly-mandated fringe benefits, but even more importantly, it has reflected the continued disappointing and puzzling behavior of productivity. The slowing in productivity gains over the past decade has been one of the grave weaknesses in our economic life, for it is putting severe constraints on our ability to raise our living standards while reducing our ability to compete in international markets. Last year, productivity in the private business sector increased by less than half of one percent--compared with an annual average increase of 3.1 percent in the first two postwar decades--and in the first quarter of this year, productivity actually declined substantially. As a result of the collapse in productivity, and the rise in compensation costs resulting from social security tax increases and the higher mimimum wage, unit _labor costs_ have soared this year, while _wages_ have decelerated.

The moderation in wages while inflation has remained so high has resulted in a substantial reduction in consumer

purchasing power. During the first five months of this year, real hourly wages fell at an annual rate of almost 5-1/2 percent, and would have fallen more without the January increase in the minimum wage. And given the small increase in nominal earnings in June, real wages probably declined further during the month.

The squeeze on real incomes explains, in large measure, the sluggishness of retail sales this year. In real terms, retail sales have declined 6 percent over the first six months of the year.

To be sure, some pause in consumer buying was to be expected this year after the unusually rapid pace of consumer spending in the final months of 1978. Historically, a buying binge such as occurred in the fourth quarter of last year is followed by a period of consumer moderation. The moderation has continued too long, however, to be merely a reaction to earlier free-spending. The consumer is increasingly constrained by declining real incomes, heavy debt repayment burdens, lack of adequate availability of the products he is willing to buy--small, fuel-efficient cars--and, more recently, by the necessity to husband gasoline. It is difficult to maintain normal shopping habits if one spends an abnormal amount of time queuing up for gasoline, and spends an abnormal proportion of income once one reaches the pump. Reduced traffic at shopping malls testifies to the OPEC impact on our domestic economic developments.

The weakness in consumer spending in recent months is being reflected down the production chain to industrial output and employment. Employment gains in recent months have been much smaller than earlier in the year, and employment in manufacturing has declined--modestly--in each of the past three months. It is worth noting, however, that unemployment has declined in all but one month this year, and the latest unemployment rate reported by the BLS, 5.6 percent, is the lowest in almost 5 years. Nevertheless, continued sluggishness in retail sales will undoubtedly result in some downward adjustment of business production and employment schedules in the months ahead.

One factor that has sustained the economic expansion so long has been the prompt adjustment businesses have made in output to avoid excessive inventory buildup. There was an acceleration in business accumulation of inventories earlier this year, partly to replace stocks depleted by the surge in consumer spending late in 1978, partly in anticipation of strike-interruptions, partly in anticipation of further inflation. But the latest figures indicate some

slowing in the rate of inventory additions at the manufacturing level, and purchasing agent reports suggest increased caution in business buying plans for materials. Inventory/sales ratios are low by historical standards, except for certain specific areas such as the larger-size autos.

One of the elements of strength in the economic picture, therefore, is that we are not weighed down with large, excess inventories that would have to be liquidated abruptly if consumer spending deteriorated further. Moreover, business capital spending plans, and appropriations to implement these plans, remain relatively strong. New orders for capital goods, other than defense items, returned to a respectable rate of increase in May, after a puzzling sharp decline in April.

Finally, U.S. exports have been sustained at a relatively high level, some 16 percent higher in the first five months of the year than the monthly average in 1978. Foreign demand for our agricultural products remains strong, and continued sizeable increases in nonagricultural exports are likely.

Thus, the economy does not demonstrate the characteristics that in the past have preceded a sharp or prolonged downturn. Sluggishness--teetering on the edge of a mild recession--is probably a better characterization of the current state of the economy, a sluggishness induced by the inflation-erosion of consumer purchasing power, and by consumer and business uncertainties about the cost and availability of energy supplies.

We expect this sluggishness to continue for several months, at least until abatement in the rate of inflation permits an end to the decline in real incomes. When consumer purchasing power begins to improve, spending will, too. Since businesses have kept the rate of inventory accumulation closely tied to the rate of sales, a resumption of consumer purchases should be accompanied by some inventory rebuilding. It is reasonable, therefore, to expect the decline in economic activity this year to be mild and, in terms of postwar cyclical experience, of relatively short duration.

Economic activity should be on the rise later this year or early in 1980. But the recovery next year should also be moderate, in part because still unacceptably high rates of inflation will require continued fiscal austerity.

<u>Energy</u>. The OPEC oil price actions since December have been a major factor depressing economic progress and intensifying inflationary pressures in the United States, and the impact of these price increases on growth and inflation will continue to be felt in the months ahead. We estimate that growth in real GNP will be lower by about 1 percent this year and by another 1 percent in 1980, and inflation about 1 percent higher in each year, than would have been the case if OPEC had adhered to the oil price schedule announced last December. As a consequence of the price actions taken since December, there will be 800 thousand more persons unemployed by the end of 1980 than forecast earlier, raising the unemployment rate by approximately 0.8 percent.

Ours is not the only economy, of course, that is having to make difficult adjustments to escalating oil prices and diminished oil availability. It is estimated that the direct, first round effect of the 60 percent rise in world oil prices since last December will be to cut one percent from the average growth rate of OECD countries in 1979, and 1-3/4 percent in 1980. It will add 1-1-1/2 percent to the average OECD inflation rate in 1979, and 2-2-1/2 percent in 1980.

Despite the higher oil import bill, we expect further substantial reductions in the U.S. current account deficit--perhaps even a small surplus next year--because of the reduction in non-oil imports associated with slower growth in our domestic economy, because of continued strong export performance, and because of increased earnings on our overseas investments.

More generally, however, the oil price increase will reverse much of the progress that had been made in improving the world balance of payments. As the OPEC surplus, which had nearly disappeared last year, again surges to levels reminiscent of 1974-75, the OECD countries as a group will move from surplus into deficit. And the position of the non-oil developing countries, already in large deficit as a group, will deteriorate sharply, increasing the problems of some of the poorest nations.

These problems were recognized and addressed directly at the recent Summit meeting in Tokyo. The world leaders assembled there concluded:

- First, there is no alternative to conservation in the short-run. If we do not deliberately

reduce our consumption of oil in ways that are least damaging to our economy, conservation will be forced by whatever increase in price it takes to reduce demand to the level of supply.

- The Summit nations each committed themselves to limits on oil imports in 1979 and 1980, limits that will apply on a country by country basis. The limit for the United States is 8.5 million barrels a day in both years--equivalent to our imports in 1977.

  For the medium-term, the Summit countries adopted specific goals for a ceiling on oil imports in 1985, goals which--assuming reasonable rates of economic growth over the period--will require very powerful efforts to limit oil consumption and develop alternative sources of energy.

- Finally, the Summit participants launched major initiatives to make use of alternative energy sources, particularly coal.

Implementing our Summit commitments will, in the longer-run, require difficult decisions and hard choices. The investment costs of developing alternative energy supplies will impinge on the availability of resources for other purposes. Personal as well as governmental budgets will feel the impact.

But in the end, there really is no choice. If we remain so dependent on imported energy, we will ultimately pay an even greater price, both in monetary terms and in terms of world leadership. Some months ago I reported to the President the results of a year-long study conducted by the Treasury of the threats to our economic welfare and national security posed by our heavy dependence on imported oil. We concluded that this threat was real and imminent. Recent events have underscored that finding.

Conclusion. As we survey the economic outlook here and abroad, and try to match the range of policy tools available for restoring adequate rates of growth and reducing inflation with the varied and serious problems we face, some guiding principles emerge:

- It would make no sense at this stage to rush in with a program to pump up the economy by either a new tax cut or spending programs, or by an easing of monetary restraint.

  -- There is not a sufficient body of consistent evidence to justify "pushing the panic button" on macro economic policies. There could be no credibility--at home or abroad--in our dedication to conquer inflation if we were to switch policies with each swing in the statistics.

  -- Traditional countercyclical economic policies simply do not address the root causes of our current slowdown or of the current double-digit inflation. In fact, an expansionary policy now would aggravate inflationary pressures, and divert resources needed to solve our productivity and energy supply problems.

- We must aggressively pursue policies to encourage conservation of oil and to increase the availability of domestic energy sources and to make more rational use of them, thereby lessening our dependence on foreign energy sources, for which the costs and availability are outside our control.

- We must reduce the gap between wages and unit labor costs. That means pursuing policies to restore productivity, particularly by encouraging more rapid growth in and rejuvenation of our capital stock. It also means holding down the rise in the costs of fringe benefits, such as health care.

- We must avoid being trapped into a wages-chasing-prices cycle such as characterized the 1975-77 period, when we suffered from a relatively high underlying rate of inflation despite significant underutilization of labor and industrial capacity. The costs of compensating labor for past losses of real income must not be imposed on the future price structure. This would be a futile process, for it would merely perpetuate the inflation that already threatens the maintenance of our living standards. The principle of voluntary compliance with a program for deceleration in prices and wages must be preserved.

- We must protect the value of the dollar in international markets, for depreciation of the dollar feeds back into higher inflation domestically.

The fiscal policies recommended by the President last January, and reaffirmed in this mid-session Budget review, conform to these principles. We are not wavering in our dedication to the fight on inflation.

Neither are we heedless of the slowing in the pace of economic activity. If, at some point in the future, countercyclical policies prove to be necessary, the choice of measures will have to be considered most carefully. There are significant constraints on our flexibility in coping with cyclical disturbances.

-- We will have to avoid policies that might jeopardize the strength of the dollar in foreign exchange markets.

-- We will have to avoid policies that would increase the share of output absorbed by government at the expense of the private sectors.

-- We will have to emphasize those fiscal policies that contribute to our fight on inflation by reducing costs and encouraging greater productivity growth.

These are relevant and serious considerations in appraising the appropriateness of policy alternatives. But they are not problems requiring resolution at the moment.

With both inflation and recession prospects so much a function of energy supplies and prices, our immediate priority must be the implementation of a program that puts us far along the road to mastery of energy problems. The President will shortly be announcing the next steps in his program in meeting our energy objectives.

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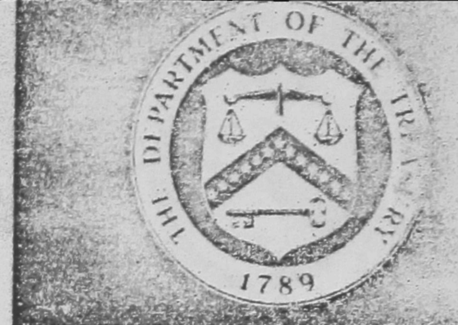

FOR IMMEDIATE RELEASE

July 16, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,900 million of 13-week bills and for $3,001 million of 26-week bills, both to be issued on July 19, 1979, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 18, 1979			:	26-week bills maturing January 17, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	97.647a/	9.309%	9.69%	:	95.349	9.200%	9.81%
Low	97.636	9.352%	9.74%	:	95.304	9.289%	9.91%
Average	97.640	9.336%	9.72%	:	95.321	9.255%	9.87%

a/ Excepting 1 tender of $10,000

Tenders at the low price for the 13-week bills were allotted 19%.
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	$ 57,140	$ 37,140	:	$ 47,055	$ 27,055
New York	3,838,865	2,365,145	:	3,335,335	2,460,585
Philadelphia	26,885	26,885	:	17,675	17,675
Cleveland	35,360	35,360	:	24,500	24,500
Richmond	33,890	32,040	:	22,635	22,635
Atlanta	44,860	44,860	:	29,130	29,130
Chicago	214,135	85,035	:	258,755	143,755
St. Louis	29,070	19,070	:	27,910	21,910
Minneapolis	20,895	20,895	:	20,995	20,995
Kansas City	32,130	29,900	:	31,775	31,775
Dallas	16,860	16,860	:	13,920	13,920
San Francisco	338,110	148,110	:	247,720	142,720
Treasury	39,075	39,075	:	43,985	43,985
TOTALS	$4,727,275	$2,900,375	:	$4,121,390	$3,000,640
Type					
Competitive	$2,745,290	$ 918,390	:	$2,635,765	$1,515,015
Noncompetitive	547,945	547,945	:	432,870	432,870
Subtotal, Public	$3,293,235	$1,466,335	:	$3,068,635	$1,947,885
Federal Reserve and Foreign Official Institutions	$1,434,040	$1,434,040	:	$1,052,755	$1,052,755
TOTALS	$4,727,275	$2,900,375	:	$4,121,390	$3,000,640

1/Equivalent coupon-issue yield.

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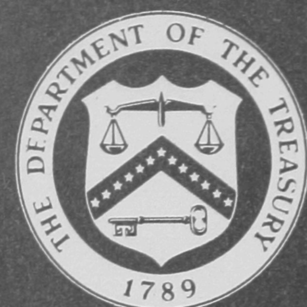

FOR RELEASE UPON DELIVERY
Expected at 10:00 a.m.
July 16, 1979

Testimony of the Honorable Robert Carswell

Deputy Secretary of the Treasury

Before the

Senate Committee on Banking, Housing and Urban Affairs

Mr. Chairman and members of this distinguished Committee:

I appreciate this opportunity to present the Administration's views on the important international banking issues being addressed at this hearing. Given the diversity of subjects before this Committee, I would like to discuss each separately beginning with the Federal Reserve Board's new regulation to implement Section 3 of the International Banking Act of 1978.

EDGE ACT CORPORATIONS

In the International Banking Act of 1978 the Congress provided for the first time a comprehensive regulatory scheme for foreign bank activities in the United States. As part of this comprehensive effort, the Congress in Section 3 of that Act directed the Federal Reserve Board to eliminate or modify any unnecessary restrictions or limitations that disadvantage Edge Act corporations in competing with foreign banks in the United States or abroad.

Pursuant to this Congressional directive, the Federal Reserve Board issued proposed revisions to Regulation K, which governs Edge Act corporations. On June 14 after receipt of a substantial number of comments on the proposed regulation, the Board issued a final regulation. A variety of international banking rules were consolidated in the revised regulation, its administrative procedures were simplified and the lending and capital requirements of Edge Act corporations were significantly liberalized.

When the proposed revisions were issued for public comment two sections were especially controversial, and I understand they are the focus of the Committee's attention. One proposed section authorizing interstate branching by Edge Act corporations was adopted as part of the final regulation. The other section proposing a change in the criteria for defining the domestic business these corporations may conduct was withdrawn and is being studied further by the Board.

Interstate Branching

While questions have been raised about the legal authority of the Board to permit such branching under section 25(a) of the Federal Reserve Act, interstate branching by Edge Act corporations appears to be consistent with the objectives of the International Banking Act. Heretofore, a bank had to charter a separate corporation for each state in which it wanted to have an Edge Act office. Consequently, a number of banks currently operate separate Edge Act corporations in several major financial centers around the country. Branching would be a more efficient form of operating in terms of management control and administrative expense. It would also permit more efficient utilization of capital funds by banks owning Edge Act corporations.

Every Edge Act corporation must have minimum capital of two million dollars while parent banks must not have more than 10% of their capital invested in Edge Act corporations. Branching -- which would be subject to prior regulatory approval -- allows a corporation to have more than one office for the same capital investment. This leverage may be crucial to the establishment of multi-state offices by smaller regional banks with limited capital to invest in Edge Act corporations. Their participation in international banking should therefore be facilitated, advancing one of the express objectives of the IBA.

In addition, interstate branching by Edge Act corporations is consistent with the principle of competitive equality between American and foreign banks operating in the United States. The International Banking Act permits a foreign bank in certain circumstances to operate branches with Edge Act deposit-taking powers outside its "home" state. It seems appropriate to provide domestic Edge Act corporations with a flexibility comparable to that provided to foreign banks.

Qualifying Customer Criteria

You have asked as well whether Edge Act corporations should maintain an export-import orientation. At the present time all of the domestic business of Edge Act corporations must be incidental to international or foreign business. The Federal Reserve Board proposed to modify this requirement in the section of Regulation K that it withdrew for reconsideration. The Board had proposed that Edge Act corporations be able to do business with any customer if two-thirds of that customer's purchases or sales were directly attributable to international or foreign commerce. The Federal Reserve notice pointed out that this more liberal standard would ease supervision of Edge Act corporations and give them increased operating flexibility.

The rather arbitrary restrictions to which Edge Act corporations are subject have long created administrative problems, and we would see no reason why the Federal Reserve should not explore ways to reduce those problems. It would also seem appropriate to consider modifications that would better enable Edge Act corporations to compete in the international banking market. The line between international and domestic banking is not a clean one, and to the extent that this proposal permits Edge Act corporations to engage in purely domestic banking activities, it can be viewed as raising interstate branching issues that have traditionally been considered in the context of the McFadden Act. At the request of Congress, the Treasury Department (at the direction of the President) is chairing an interagency study of the McFadden Act and its relevance to present-day banking. We would expect to cover this range of issues in that study.

BANK ACQUISITIONS

Since 1970, foreign banks have acquired at least 59 American banks with assets at the time of acquisition in excess of $20.6 billion. As banking becomes a global activity more

foreign banks may recognize the competitive advantages of a significant American representation. Unfavorable political and economic prospects in some other countries accentuate the advantages of doing business in the United States. In addition, there are a large number of privately owned banks in the United States relative to the number of such institutions in most foreign countries. At present many banks are viewed as attractive investments with equity prices well below book value and favorable price/earnings ratios.

The traditional policy of the United States Government toward international investment is neither to promote nor to discourage inward or outward investment flows or activities. This policy is based on a careful and pragmatic assessment of the national self-interest, though it comports as well with our philosophical preference for open markets and a minimum degree of government interference. Investment in this country which originates from abroad benefits our economy; indeed much of this nation was built with foreign capital.

Foreign investment in American banks has generally brought to our banking system additional capital, management skills and increased competition. This has been especially true in recent acquisitions. Many of the banks acquired needed financial and managerial assistance. Many also became parts of larger international financial organizations better able to compete with the largest American and foreign banks in domestic and foreign markets. Virtually all of the major banks acquired recognized the advantages of their association with a foreign institution and overwhelmingly endorsed the combination.

No one can predict with any assurance whether the acquisition of large American banks by foreign persons will continue at a relatively high level and whether a significant number of American banks will eventually be foreign owned. The economic, cultural and political considerations that influence acquisitions are not the same for all large foreign institutions and the value of the dollar vis-a-vis foreign currencies has fluctuated widely in recent years. Nonetheless, the potential for major acquisitions in our banking sector is something that requires our continuing attention.

Banking is at the core of the nation's economy; hence significant foreign ownership could raise questions as to whether such ownership is consistent with the overall best interests of the nation. These questions are difficult to articulate. As of today there has been no suggestion that any significant past bank problem was the result of, or

facilitated by, foreign ownership. The potential problems associated with foreign ownership cluster around two related issues: (i) added difficulties in assuring the safety and soundness of the bank; and (ii) possible diversion of credit and service from, and concomitant injury to, the area or market served by the bank.

Banking is a comprehensively regulated industry, and the regulators are presumably in the best position to comment on these problems. To the extent that particular foreign ownership would prejudice the safety or soundness of the institution, clearly such an acquisition should not be permitted--just as a domestic acquisition would not be permitted in similar circumstances. We understand the regulators feel they have adequate power to deal with this type of issue.

The second issue -- the risk that foreign ownership may limit or deprive United States customers of service or credit -- is difficult to evaluate. Clearly a foreign owner is subject to the laws of his home country and that could -- at least in extreme situations -- lead to pressures that might be inimical to the United States. However, in that type of situation the regulators have power to prevent precipitous actions by the bank and the President could also invoke his emergency powers to block assets under the International Emergency Economic Powers Act. It is also not likely that all foreign owned banks would act uniformly; so the risk of sizeable dislocations is not likely to be high.

If the concern is that the bank may shift its business emphasis when controlled by a foreigner, there are similar risks when control shifts between domestic persons. I would also point out that it is not entirely realistic to assume a foreigner would acquire a bank and then deliberately take actions that would alienate the bank's customers and its standing in the community. That type of action would surely reduce the bank's deposit base and the value of the foreigner's investment. It would also encourage competitors and attract new entrants to the market. Also, all insured banks (including foreign-owned banks) are subject to the Community Reinvestment Act.

I should also stress that in addition to general supervisory powers over banks, the regulators today have the power to disapprove all significant acquisitions, domestic and foreign. They do not have the power to disapprove merely because the acquirer is foreign but they do if the particular foreigner presents a question as to whether he will operate the bank on a safe and sound basis. The change in the Bank

Control Act, which the Congress enacted just last year, contains new provisions that are especially tailored to cover bank acquisitions by individuals. While there has been only limited experience to date with these new provisions, it appears that the standards contained in the Act are broad enough to assure that the regulators have the power to make a comprehensive review of acquisitions by domestic or foreign individuals.

We conclude that at its present level, foreign ownership of United States banking assets does not pose any undue risks. Accordingly, we do not see any need for an artificial percentage limitation on foreign banking assets in the United States. However, we do feel that the situation should be followed closely, and the two Treasury studies underway on the treatment of U.S. banks abroad and on the McFadden Act should provide useful insights generally in this area.

I will also ask the Interagency Coordinating Committee to consider adopting a more comprehensive and contemporaneous reporting system so the Congress and the regulators themselves will have more complete and timely information about foreign ownership. This should facilitate the timely review of proposed acquisitions and provide the Congress with information so that it too may better monitor developments in this area.

The bank regulators, as part of their approval process for acquisitions, are looking into a variety of issues. They are interested in the special circumstances of hostile takeovers of American banks and whether the acquisition or ownership of our banks by foreign government owned institutions poses any special problems. They are also working with foreign bank regulators to improve the process of verifying financial information on proposed foreign acquirers and monitoring financial transactions between an overseas bank and its domestic subsidiary.

Given these various inquiries into foreign bank acquisitions of American banks, we believe it is not necessary to initiate another study as proposed by S.J. Res. 92. If, after the studies now in process are completed, further work is required, that would be the time to expand on their conclusions. We are particularly opposed to any moratorium on acquisitions. Such an action could undermine foreign confidence in our open-door investment policy. It could be viewed as a forerunner of restrictions on acquisitions first in banking and then in other industries.

INTERNATIONAL BANKING FACILITIES

The Treasury Department has favored the establishment of international banking facilities (IBFs) in New York City. On December 22, 1978 Treasury advised the Federal Reserve Board that it endorsed the thrust of the New York City Clearing House banks' IBF proposal.

In theory, the IBF proposal would relocate to this country some of the activities that American banks are now conducting overseas. We are not in a position to confirm that these facilities would bring to the United States a significant amount of international banking business and the job opportunities associated with it. But to the extent they have such an effect, the results would obviously be beneficial. Our support for the proposal assumes that the operation of these facilities would have no adverse effect on the conduct of monetary policy, and on the supervision and stability of the banking system. In our opinion, the New York IBF proposal would have no significant effect on Federal tax revenues and the Office of the Comptroller of the Currency believes there would be no unmanageable bank supervision problems. Indeed, the return of certain of these off-shore activities to offices within the United States might facilitate the supervisory process and the ability of the regulators to gauge the safety and soundness of the banks.

You have asked about the effects that the IBF might have on our monetary policy and our balance of payments. We would expect the IBF to have a minor positive effect on our balance of payments. For purposes of monetary policy, it would appear that the flow of funds between American bank main offices and IBFs could be controlled much as the flow of funds between main offices and overseas branches is now controlled. The increased proximity of the offices should not make that much difference, but we would want to rethink our opinion if the Federal Reserve Board or any of the other bank regulators were to reach a different conclusion.

The Federal Reserve, the Administration and the Congress are presently considering a major revision of domestic reserve requirements and the appropriateness of reserve requirements on Eurocurrencies. If in the future, because of legislative or Federal Reserve action, domestic and foreign reserve levels were so close as to eliminate any significant reserve advantage to IBFs, these facilities could still be useful. The country-risk exposure of American banks doing business abroad and of their customers could be favorably affected by

doing more of that business in the United States. In addition, IBFs would have the advantage of exemption from state or local taxes on their activites if other states acted like New York State in eliminating such taxes.

Other states may want to have IBFs for the use of their own banks. This would seem to be an appropriate means of spreading the competitive benefits of these facilities. Non-New York State banks have expressed a strong desire to have their own IBFs located in New York City whether or not they have them in their home state. We would hope that the technical difficulties raised concerning clearing activity at the New York Clearing House and the Federal Reserve can be favorably resolved on a non-discriminatory basis. This should assure a broad base of competition among banks in their IBFs.

* * *

Thank you Mr. Chairman. If there are any questions I would be glad to try to answer them.

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STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON COMMERCE, CONSUMER
AND MONETARY AFFAIRS
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

Introduction

The events of the past few weeks have reminded us, as seldom before, of the intense interdependence between our own economy and that of other countries. The success of the United States in creating jobs for our workers, and in reducing the rate of inflation for all our people, depends critically on our ability to forge effective working relationships with a large number of nations -- industrialized nations, such as those with which President Carter met at the Tokyo Summit at the end of June, and developing nations, including some which supply to our economy critical raw materials such as petroleum.

Indeed, this interdependence should have been apparent to the American people for most of this decade. During the 1970s, we have felt the ravages of global inflation which turned quickly into global recession. Since 1973, we have experienced massive increases in the world price of oil which have produced dramatic changes in national balance of payments position and international financial developments, in addition to their impact on inflation and recession.

The stability of the world economy has been sorely tested by these events. Some observers predicted a collapse of the international financial system. Some predicted a

return to the protectionism and beggar-thy-neighbor policies which deepened and broadened the Great Depression of the 1930s. Some even foresaw a resort to military means to protect access to raw materials or other vital national interests.

Fortunately for all of us, none of these dire events has occurred. To be sure, we continue to experience an intolerable level of inflation, the threat of at least a mild recessi' ', concern about the dollar, and longer run worries about the availability of adequate supplies of energy. These issues will continue to preoccupy the President and the Congress of the United States for years to come.

But one piece of very good news is that the international economic system has held. Protectionism has been largely held at bay, and trade has in fact been liberalized through the Multilateral Trade Negotiations (MTN) in Geneva. Balance of payments adjustment has taken place -- the United States ran a current account surplus in the first quarter of this year, while Japan ran a current account deficit. The petro-dollars have been recycled successfully. The debt problems of both industrialized and developing countries have been managed effectively. The industrialized countries have learned how to coordinate their policies much more effectively, including at Tokyo in the critical area of reducing oil imports.

This ability to cope can be largely attributed to the success of the United States, over the course of the entire postwar period, in leading the world toward the creation of an international economic system based on the market principles which have lain behind the unprecedented historical success of our own economy. The goal of the United States has been maximum freedom for trade, investment and capital movements -- and our success in pursuing that goal has created an inter-dependent world economic system in which all major countries best serve their own economic interest by adopting and maintaining policies which preserve and defend that system. Any retreat from that approach by the United States could jeopardize all that has been built, and with it some of our own most important economic, political and philosophical objectives.

I begin my testimony with these references to inter-national economic interdependence, and to the continuing themes of postwar U.S. international economic policy,

because they provide the framework within which I will seek to answer the specific questions raised in the Chairman's letter of invitation to me to testify today. These questions relate to the amounts and objectives of investment by OPEC countries in the United States, the impact of such investments on our economy and financial system, the adequacy of the data which are now collected on such investments by the U.S. Government, our policy on disclosure of certain of these data, and the ability of the United States to defend itself against any withdrawals of assets by foreign investors in the United States. I ill address each of these questions in my statement, and provide annexes with detailed answers to each question raised in the Chairman's letter.

The Level of OPEC Investments in the United States

A number of OPEC countries have experienced large balance of payments surpluses following the quadrupling of the oil price in 1974, and hence have had a substantial volume of money to invest outside their own borders. We estimate that residents of these countries had invested only a few billion dollars in the U.S. prior to 1974. Since January 1, 1974, however, roughly $46 billion -- approximately 20 percent of estimated cumulative investable surpluses of all OPEC countries during that period -- has been invested in the United States or used to amortize debt (Table 1). Thus, we estimate the total value of OPEC holdings in the United States at the end of last year at about $42 billion (Table 2). About 80 percent comes from Middle East oil-exporting countries (Table 3). These numbers should rise further in the next year or two: after dropping to only $5 billion in 1978, the OPEC surplus is likely to rise again to over $40 billion in both 1979 and 1980 (Table 4).

These are sizable numbers. However, in every case they represent a modest percentage of total foreign investment in the United States -- and a tiny share of total investment, foreign and domestic, in such assets (Table 5):

- -- the oil-exporting countries account for 9 percent of all foreign holdings of Treasury securities, and about 1.6 percent of all holdings of Treasury debt;

- -- they hold an estimated 20 percent of all foreign investments in U.S. corporate and other securities, but only about six-tenths of 1 percent of all outstanding U.S. equities and about seven-tenths of 1 percent of all outstanding U.S. corporate bonds;

-- they account for less than 10 percent of all liabilities to foreigners reported by banks in the United States, and for less than 1 percent of the total of $1.1 trillion of deposits held by Americans as well as foreigners in those banks;

-- their direct investment holdings amount to less than 1 percent of all foreign direct investment in the United States, and something on the order of one hundredth of one percent of the net worth of all U.S. firms.

Hence it would be difficult to conclude that any possible withdrawals of investments of oil-exporting countries constitute a threat to the U.S. economy or financial system. The magnitudes involved would simply seem to belie any such possibility. Indeed, the first conclusion cited by the General Accounting Office in its report of July 16 to this Subcommittee is that "these holdings do not constitute an immediate danger to U.S. banks or the economy."

A word of background on the nature of these investments in the United States by oil-exporting countries, particularly concerning how their official holdings differ from those of virtually all other countries, may be useful. Since World War II, the dollar has been the principal currency used in international trade and the principal currency used by monetary authorities when they intervene in the foreign exchange market to influence their exchange rate. When countries have increased their official reserves, most of those increases were acquired and held in the form of dollars. Most of these dollar reserves were, in turn, invested in U.S. Treasury securities or in bank deposits in the U.S. Some were deposited with banks in the Eurocurrency market.

Most of the OPEC countries followed the same practice until 1974, when the price of oil was quadrupled (although some had had close ties to sterling). In most of these countries the revenue from oil exports accrued directly to the governments, not to private entities. To a considerable extent, the excess of revenues over the demand for foreign exchange from other government entities and the limited private sector was viewed in the traditional way as an increase in reserves. The monetary authorities tended to invest the funds in dollars -- a substantial part in the U.S., mostly in U.S. Government securities.

But for some of these countries the accumulations were such -- and the prospect of further surpluses was such -- that some of the funds were not really needed as liquid reserves, but could be used for longer-term investments. In some cases, the monetary authority has continued to manage both the "reserves" and the "investments." In some, a separate agency was established to handle the funds not counted as reserves. There are a few non-OPEC countries (e.g., state trading countries) where various government entities other than the central bank hold dollars in the U.S., but few if any instances of government operated investment funds.

In U.S. statistics the bulk of these holdings of OPEC government agencies, whether considered by these governments as reserves or investment funds, are reported as liabilities to official holders. Our use of the term "investment" thus covers both types. In addition, U.S. liabilities to private entities in a number of OPEC countries are negligible whereas U.S. liabilities to private entities are substantial in most non-OPEC countries which have significant holdings in this country. Any discussion of OPEC investments in the U.S. must take account of these special factors.

The Impact of OPEC Investments on the United States

We are fully satisfied that the U.S. has benefitted from the placement of these funds in the U.S. We cannot, of course, guarantee that every foreign investment in the United States has brought identifiable gains to U.S. productivity. But the inflow of capital which these funds provided has helped finance our balance of payments deficits, added investment capital to foster domestic growth and create jobs, helped to finance the external lending activities of U.S. banks, and contributed to the strength of the dollar and the overall stability of the international monetary system.

The past three decades have been characterized by a progressive liberalization of international trade and capital flows, developments which have catalyzed rapid and sustained increases in the wealth and living standards of the industrial countries and progress in the developing world. Beyond the economic gains from specialization and efficient resource allocation, a result of this movement toward an open system of trade and capital has been an increasing degree of international economic interdependence. The industrial and agricultural structures of individual nations are now heavily dependent on sources and markets abroad.

The extent of U.S. involvement in world trade, and therefore in the global economy, is frequently overlooked.

-- We are the world's largest exporter, in 1978 selling $140 billion in U.S. goods and $36 billion in U.S. services abroad;

-- One out of every eight manufacturing jobs in this country, and one out of every three acres of American farm land, produce for exports;

-- We import more than $170 billion in goods from abroad. These imports provide essential inputs for U.S. industry, including more than o: -fourth of U.S. consumption of twelve of the fifteen key industrial raw materials;

-- Our total trade, exports plus imports, is now equivalent to about 15 percent of U.S. GNP, double the figure of just over a decade ago.

There is an integral relationship between the international flow of goods and the flow of investment capital. Countries -- just like firms -- cannot buy more than they sell unless they can borrow funds to finance the purchases. Similarly, there is no incentive for a country to sell more than it needs to buy unless there are opportunities for safe and profitable investment of the surplus funds. Our economy is highly dependent on trade and a vigorous world economy. That, in turn, is dependent on an open system of international payments and capital flows.

The world and U.S. economies have benefited greatly from the expansion of world trade and capital flows, in terms of increases in employment and standards of living far greater than would have been possible if we and other nations had raised, rather than lowered, the barriers to international trade and payments.

An essential element in the preservation of an open trade and payments system has been our policy toward international investment. A country cannot run a deficit in its balance of payments on external account without financing the deficit through some form of capital inflow (except by selling off existing claims on foreigners). A U.S. readiness to accept foreign investment, including investment in dollars by foreign central banks, is a crucial element in the operation of the international monetary system.

We impose no restrictions on the use of the U.S. dollar by non-residents, with minor exceptions to which

I will refer later. Broadly speaking, non-residents, whether official or private, have the same access to U.S. money and capital markets as have our own citizens. We do not discriminate on the basis of race, religion, nationality, color or creed in the application of this policy any more than we do at home.

With respect to equity investments in U.S. firms, the principle is the same. Only in a few highly sensitive strategic industries, such as the production of fissionable material, has Congress called for restrictions on investment by foreigners that are not applicable to domestic residents. The question whether any special provisions with respect to the purchase of American banks by non-residents are advisable is being discussed currently by the Senate Banking Committee. The Treasury does not believe that at its present level, foreign ownership of banks poses any undue risk, although the situtation should be followed carefully. The general, underlying principle is to afford the same privileges and responsibilities to the non-resident investor as to a resident. Therefore, we neither promote this type of investment by foreigners nor discourage it. So long as it takes place in response to market forces, we welcome it.

This policy is based on a careful and pragmatic assessment of the national self-interest, though it comports as well with our philosophical preference for open markets and a minimum degree of government interference. Investment in this country which originates from abroad should be no less beneficial to our economy than investment which originates here.

Concerns About OPEC Investments

I understand the concern of this Subcommittee to be not whether overall U.S. investment policy is right or wrong, but whether sufficient data are being collected and adequately analyzed to ensure proper implementation of that policy and of specific legislation with respect to the collection and analysis of data. You have indicated concern with the adequacy and analysis of information on the investments -- financial and direct -- of residents of the 13 countries which are members of OPEC.

The question of whether OPEC investments should be viewed differently from other investments presumably arises because most of these investments are made by government bodies in these countries. There is no basis for considering investments in the U.S. by private individuals

or firms that happen to be residents of an OPEC country in a different manner than investments by residents of other nations. Obviously, however, there is a possibility that a foreign government could use its assets in the U.S. to pursue political objectives contrary to our national interests.

Considerable public concern was expressed about the possibility of politically motivated investments in the U.S. by foreign governments when a number of OPEC countries began to accumulate large amounts of funds. The government responded to these concerns in 1975 by establishing a special procedure which called for advance notification to the U.S. Government of any major investment in the U.S. by a foreign government (excluding investments in U.S. government securities, bank deposits, etc.) and for review by a special inter-agency committee of any foreign governmental investments here which might have adverse implications for the national interest. This procedure was from the beginning, and is now, equally applicable to investments by any foreign government.

Executive Order 11858 of May 7, 1975, established the Committee on Foreign Investment in the United States, consisting of representatives of the Departments of Commerce, Defense, State and Treasury. The Order assigns the Committee responsibility for "monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment." In particular, it mandates the Committee to "review investments in the United States which, in the judgment of the Committee, might have major implications for United States national interests." The Committee gives us an orderly procedure for examining these questions to make sure that any action, or inaction, by the Government is based on carefully considered judgments of what is in the national interest.

Since the establishment of this procedure, there has been only one proposed investment by an OPEC government which was of sufficient significance to warrant its use. This was a proposed investment in the Occidental Petroleum Company by the Government of Iran in 1976. The proposal was eventually withdrawn for business reasons unrelated to the USG review. Thus, to date there have been no instances of investments by the governments of any OPEC member which have been considered significant in terms of control of, or influence in, a major U.S. enterprise. We estimate the total value of <u>direct</u> investment -- the value of equity holdings in companies in

which the foreign investor holds 10 percent or more of voting stock or its equivalent -- in the U.S. by all residents of all OPEC countries at about $325 million as of end-1978. This constitutes less than 1 percent of the direct investment in this country by foreigners, and is not a volume which poses a threat to our national interests.

In addition, it is worth pointing out that the Government of Saudi Arabia has stated publicly that a central feature of its investment policy is to limit its holdings to a maximum of 5 percent of the equity in any company. We understand that investment managers handling Saudi portfolios have been specifically instructed to observe this limit. Private Saudi citizens have made several direct investments in this country, but it is the clear policy of the Saudi Government and monetary authorities to eschew such initiatives.

The Subcommittee has raised the question of whether other kinds of OPEC investments in the U.S. -- mainly financial instruments -- are so large that our financial markets are unduly dependent on, and vulnerable to, one or a few governments who could take disruptive action for political reasons.

I have already noted that the approximately $24 billion which constitutes total holdings of U.S. securities by all residents of all OPEC countries combined is not a large enough component of our markets to constitute a major threat to our financial system. The U.S. equity and capital markets are by far the broadest and most resilient financial markets in the world. In the very unlikely event that all of the OPEC countries dumped their entire holdings of U.S. securities at one time, the markets would absorb these securities at a significant but manageable price concession. The effects might be pronounced and undesirable -- but they would clearly be manageable. As money is fungible, most of the impact would be quickly offset. The OPEC countries would either reinvest their dollar proceeds in dollar-denominated investments abroad, or would exchange these dollars for other currencies. In either event, those foreign institutions that acquired the dollars from OPEC countries would, directly or indirectly, have to reinvest the funds in the U.S.

It is important to recognize that withdrawal of dollar deposits from U.S. banks by foreign depositors, and their transfer to European banks, does not affect U.S. domestic liquidity. What is transferred is ownership of the dollar deposits, which in this case become the U.S. bank's liabilities to European banks as opposed to liabilities to the original foreign depositors. The U.S. bank still has the same liabilities available to support its asset structure. There are no actual dollars in the Eurodollar market, which is in fact a market in claims on deposits in U.S. banks, and not a market in greenbacks.

It might be worthwhile to elaborate this point. If an American firm drew a check on a bank in New York in favor of an OPEC government to pay oil royalties, the New York bank's liabilities to the firm would decline and its liabilities to the OPEC government would rise. Our data would then show an increase in U.S. bank liabilities to foreign official holders. If the OPEC government then transferred its deposit to a bank in London, the liabilities of the New York bank to the OPEC government would go down and its liabilities to the London bank would rise. Our data would show a decline in U.S. liabilities to official holders abroad, but an equal increase in liabilities to private foreigners -- a decline in our liabilities to residents of OPEC countries and a rise in our liabilities to residents of the U.K. Neither the asset-liability position of the bank nor the U.S. money supply would be affected.

If a particular bank in the United States were to be faced with a demand for an immediate withdrawal of a very large deposit, it would have numerous ways to meet that demand. To begin with, most OPEC bank deposits are not held in demand deposit form but are subject to withdrawal limitations or penalties. The mere sale of a certificate of deposit by an OPEC holder to a non-OPEC entity would not place pressure on the bank in which that certificate of deposit is held. Pressure could be applied only by demanding immediate payment. Should such a demand be made, the bank could borrow in the interbank market.

The international banking system is accustomed to interbank borrowings which may total in the billions of dollars daily and would probably be able to handle any attack on an individual bank easily. One reason there would be no

difficulty is that the funds withdrawn from one bank would have to be deposited with some other bank. The bank receiving the new deposit would find itself with excess funds which it would immediately offer in the interbank market. But even in the unlikely event that funds were not easily obtainable in the interbank market, a bank facing a large deposit withdrawal could borrow from the Federal Reserve. Governor Coldwell may elaborate on this point, but the Federal Reserve serves as a lender of last resort for banks in the United States.

Similarly, the United States has fully adequate defenses against any attempt to disrupt the U.S. Government securities market by dumping large holdings. The Federal Reserve Bank of New York maintains a secondary market for U.S. Government securities and could immediately purchase for its own account or, if necessary, for the account of the Treasury, whatever amount of such securities might be needed to maintain order in the markets. Obviously we try to avoid disruption in the securities markets, and one of the purposes of the add-on arrangements which we established for the use of governments and central banks has been to facilitate both the purchase and the sale of large amounts without disturbing the market.

Concerns have also been expressed that one or more OPEC governments might attempt to damage the United States by suddenly dumping large amounts of dollars on the foreign exchange market. Several OPEC central banks hold sufficient dollar-denominated assets, either in the United States or in the Euro-currency market, to cause considerable disorder in the foreign exchange market under certain conditions should they deliberately attempt to do so. (So, for that matter, do a good many non-OPEC central banks.) One does not need detailed statistics or a detailed analysis of individual country holdings to conclude that such capability exists.

Such events are unlikely, however, for several reasons. The first is the strong interest of major OPEC countries, expressed repeatedly by them, in the stability of the exchange rate of the dollar. Most of the investments of nearly every OPEC country are denominated in dollars, and a depreciation of the dollar reduces the value of those assets in terms of other currencies.

In addition, OPEC countries price their oil in dollars. A depreciation of the dollar in effect thus reduces the value of their oil revenues, in terms of what they could buy in many other countries.

Finally, such a political attack would have obvious implications for overall relationships between the countries involved and the United States. The likelihood of a politically motivated attack on the dollar thus seems very remote.

Even if there were a politically motivated attempt to damage the dollar, we have extremely strong defenses to counter it, as pointed out in the GAO Report. Private banks themselves could readily borrow abroad, or through the domestic inter-bank market, to offset immediately the impact of withdrawals. If official action became imperative, authority exists under the International Emergency Economic Powers Act for the President to declare a national emergency and to block any withdrawals of assets.

In addition, we could count on help from abroad. Other countries, both developing and industrial, have a very great stake in preserving international monetary stability. Central banks of countries whose currencies were being purchased would not wish to face either the effects on their exchange rate and their domestic economy, or the effect on their money supply, of providing the domestic currency themselves. I am confident that we could count on widespread cooperation to counter such a misguided attempt.

Your letter also implied a concern that OPEC governments might gain undue influence in specific U.S. companies, or specific sectors of the economy, by secretly acquiring a controlling or influential interest in particular companies by means of anonymous acquisitions of their securities, through nominee accounts in non-OPEC countries, or other indirect methods.

Any such acquisitions would contravene current laws and regulations regarding reporting of foreign investment in the United States. The Securities and Exchange Commission requires that any person acquiring more than 5 percent of a publicly traded U.S. company must report this fact to the SEC. Regulations issued by the Commerce Department under authority of the International Investment Survey Act of 1976 require

that any U.S. company whose voting stock is 10 percent or more owned by a foreign resident must report quarterly to the Commerce Department if the value of its assets, sales, or income are more than $5 million.

Obviously, there is a theoretical possibility that a foreign person determined to acquire a controlling or influential interest in a U.S. company secretly could do so by 'orking through various intermediaries and nominee accounts. It is conceivable that some foreign firms or individuals have a larger interest in more U.S. firms than now appears on our records. But the possibility that any foreign government has acquired such interests in this way in a large number of firms, or firms which are important to our economy, is too small to merit the establishment of an extensive organization to investigate such possibilities.

But let us assume for purposes of discussion that a government has acquired controlling interest in a U.S. firm which is below our reporting threshold and of which we are therefore unaware. Could a foreign government, using secretly held equity, shape the operations of a U.S. company in a manner that we would consider undesirable? The key point here is that the laws and regulations which we now have on the books presumably cover all potential abuses or misuses of U.S. companies. These laws are applicable equally to U.S. and foreign-owned companies in the U.S., and their effectiveness is not dependent on our having detailed knowledge on whether particular foreigners own particular amounts of particular companies.

Therefore, any concerns about foreign investors misusing U.S. companies presumably relate to actions of some sort which are not now covered by U.S. laws. If, in fact, particular actions are a real threat to the national interests we should have laws against them regardless of whether the actions are perpetrated by foreigners or by Americans. But we should not have laws or reporting regulations which are based on the assumption that certain actions by foreign-owned companies -- whether official

or private -- in the U.S. are intolerable even though the same actions by U.S.-owned companies would be acceptable, except in a few instances which Congress has decided to legislate such differential treatment.

For all these reasons, we see no basis for differentiating between OPEC investments in the United States and those by other foreign persons. Nor do we see a case for substantially increasing the burdens on American companies to supply more data than they now provide on these investments.

I would also like to point out that, just as we should not discriminate against OPEC investments in this country, neither should we discriminate in favor of such investments. In the Conference on International Economic Cooperation, during which there was extensive dialogue between industrial countries and developing countries, some OPEC officials contended that preferential treatment for their investments was warranted in exchange for oil production in volumes excessive to their own immediate financial needs. We and the other industrial countries rejected this approach. Thus, while we welcome investment in this country by residents of OPEC countries, just as we do investment from other countries, we give no special incentives to attract it.

Notwithstanding our ability to cope with a withdrawal of OPEC investments from the United States, we would not want to precipitate such withdrawal. As I have said, these investments provide distinct benefits to our economy. Withdrawal also could have disruptive, if manageable, effects on our capital market. As the GAO report noted, withdrawal of the investments would adversely impact on the customer relationships which have been established between the OPEC countries and our banks and other enterprises -- hurting their competitive position over the longer run. Measures which would force a withdrawal of OPEC investments would cast a pall on the investment climate in the U.S., and could lead other foreign investors to reevaluate the desirability of maintaining their investments here as well.

Data on OPEC Investments in the United States

When the oil price was quadrupled in 1974 and some of the OPEC countries began to accumulate large payment surpluses, the disposition of those surpluses became a matter of major importance not only to the surplus countries themselves but also to the entire world. In the national interest of the United States and the interest of world financial and economic stability, the U.S. Government sought to make clear to OPEC countries that investment in the United States -- particularly in U.S. Government securities -- would be welcome.

Since the amounts of the surpluses were extremely large and the U.S. monetary authorities wanted to minimize the impact of large purchases by foreign governments on the U.S. securities markets, Treasury offered facilities for the purchase of regular U.S. Government securities off-market but at market rates -- the so-called "add on" facility. The same facilities were offered to other interested governments. In addition, in response to requests from officials of some OPEC countries, Treasury officials assured those countries that the confidentiality of their government accounts in the United States would be maintained.

In 1974, Treasury found it necessary to make significant changes in its reporting systems with regard to the portfolio transactions of the Mid-East oil exporting countries in order to continue to afford confidentiality to individual investors there. Prior to that time, Treasury required reporters to submit data on liabilities to these and a number of other countries only semi-annually, and then only for specific transactions. These partial data were published by country in the Treasury Bulletin. The requirement for only partial, infrequent reports on these countries was based on the fact that their holdings in the United States were very small; there was little need for comprehensive, monthly reports which would increase reporter burden. The small size of these holdings also reflected a situation where the data collected for each country represented a mix of holdings by banks, other private residents, and official institutions.

In 1974, the holdings of residents of Mid-East oil exporting countries in the United States began to increase rapidly. Consequently, Treasury felt it advisable to change the reporting instructions to require monthly reports and to cover the whole range of portfolio transactions by residents of these countries. At the same time, as a result of the

substantial increase in official oil revenue of these countries, it became obvious that the assets held in the United States by a number of official monetary authorities would constitute a very high percentage of the total holdings of residents of those countries -- as has remained the case since that time. With this development, the continuation of the previous practice of publishing an individual country breakdown would have effectively disclosed holdings of these individual official institutions. Thus it became nec .sary to group countries in order to maintain confidentiality, as requested by some of the countries involved.

Throughout the period of data collection under the Bretton Woods Agreements Act and the International Investment Survey Act, the U.S. Government has sought to maintain the principle of confidentiality of the accounts of individual investors and reporters. An assurance that accounts of individual OPEC governments would be kept confidential therefore cannot be viewed as an offer of preferential treatment. Such confidentiality is available to all other governments as well as to private investors, domestic and foreign.

The sensitivity of governments and central banks to U.S. statistical treatment of their accounts varies. The Canadian Government, for example, has for many years accepted specific identification of its official holdings in the United States, but no other government's holdings have ever been specifically identified in U.S. statistics.

There are some instances in which U.S. liabilities to official institutions have come to constitute a relatively high percentage of U.S. liabilities of a particular type to all residents of that particular country. This is a situation which has evolved over the years as an increasing percentage of private liquid dollar balances came to be deposited in the Eurodollar market, rather than directly in the United States, while central banks of many nations were increasing their official dollar reserves substantially and continuing to hold those reserves in the United States. In the absence of expressions of concern by these governments, we have not changed our statistical presentation because we

wish to make as much information available to the public as is consistent with individual customer and individual reporter concerns. However, very rarely are the percentages of official holdings in a country's total holdings as high for other countries as for the OPEC countries which have expressed concern over the issue. 1/

The U.S. is not alone in providing protection against the disclosure of the affairs of individual customers and reporters. As far as we know, no government divulges detailed data on the investments of individual investors, including individual foreign governments or central banks. No major country releases data on the holdings within its territory of individual Middle East oil exporting countries. Indeed, no other country discloses nearly as much data as does the United States in this whole area of international capital movements.

1/ Upon re-reading my letter of April 19 to the GAO, I have concluded that its fifth paragraph may have conveyed a misleading impression which I wish to clarify. The disclosure policy of the Treasury has been applied uniformly in the sense that confidential treatment is available to any investor (1) whose investments could be disclosed, contrary to the Bretton Woods Agreements Act and the Investment Survey Act of 1976, by publication of the individual country data and (2) who wishes to take advantage of it. The Government of Canada has indicated that it has no objection to disclosure of its holdings, which are therefore disclosed. The governments of several OPEC countries have indicated that they would object to disclosure of their holdings, which would in fact occur if data for those individual countries were reported because official holdings represent such a high share of total country holdings; thus these countries are grouped with several others to avoid disclosure of the holdings of individual investors. No other governments have objected to our long-standing presentation, so we have not felt it necessary to alter our presentation. Any government which did indicate a desire to avoid disclosure of its holdings, where those holdings were found to represent the bulk of the country's total holdings, would receive similar treatment.

The Subcommittee has asked whether such treatment should continue to be extended to foreign governments. I would answer in the affirmative, for those who consider it important.

Most governments and central banks around the world -- not merely those that are members of OPEC -- consider that the details of their holdings abroad are a private matter. Most governments and central banks publish the total amount of their official reserves and give a breakdown between SDR, their IMF position, foreign exchange and gold. Very few countries release a breakdown of their foreign exchange reserves by currency but it is widely known that, for most countries, the great bulk of those holdings are in dollars. It is known that the major industrial countries hold most of their dollars in U.S. government securities. Thus they have not expressed concern over the publication of disaggregations in which official holdings have come to constitute a high percentage of the country total.

Whenever and to whatever extent confidentiality is sought, however, we do our best to maintain it. Some OPEC countries may be more sensitive on this issue than some of the industrial nations whose external government-owned assets are all in the category of liquid reserves because, as I noted earlier, some of their holdings are more akin to an investment portfolio than liquid reserves. Nevertheless, the basic principle is available to all.

Finally, the Chairman's letter of June 26 raised the question of whether "some form of understanding, promise, agreement, or arrangement" exists between the United States and any OPEC country regarding data disclosure. I have already indicated that several OPEC countries have repeatedly expressed concern about the confidentiality of their investments in the United States, leaving a clear implication that they might be less inclined to invest here in the absence of such confidential treatment. I have also indicated that the Treasury Department, in expanding its reporting on investments by OPEC residents, changed its treatment of the holdings of some OPEC countries in 1974, in conformity with the requirements of the Bretton Woods Agreement Act, in light of the requests of these countries that it do so.

The Treasury files contain no evidence of any explicit agreement on the subject, although former Secretary Simon has indicated that such an agreement did in fact exist. We can assure the Subcommittee that no such arrangement has ever been mentioned, let alone agreed or carried on, during the present Administration -- though representatives of several OPEC countries have reiterated to us on several occasions their concern over the continuing confidentiality of their holdings. Indeed, the level of investments in the United States by these countries has fluctuated rather widely during the past few years, which is inconsistent with the notion that any such arrangement was in place at least during that period.

The primary determinant of the level of OPEC investments in the United States is the level of the OPEC investable surplus. The proportion of this surplus invested in the United States ranged from 21 percent in 1974 to a high of 30 percent in 1976 and fell back to a level of 14 percent in 1978. From mid-1978 through the first quarter of 1979, OPEC investments in the United States actually declined. The principal reason was that, during that period, these countries had no significant surplus while they had continuing commitments for grants and disbursements on earlier loan commitments.

I have attached to my testimony as much of the detailed information which the Subcommittee has requested on all of these topics as is available to us, and as I can disclose. We have provided to the Subcommittee over three hundred documents from our files containing material relating to these investments which do not bear a national security classification. We have also provided lists of other documents, copies of which we have not provided for several different reasons.

We have been unable to furnish classified materials because, in response to our question as to whether the Subcommittee and its staff would maintain the confidentiality of classified documents, we were told that the Subcommittee would wish to reserve for itself the right to release any documents it received. If the Subcommittee should now be of the view that it can give such assurance, we would be pleased to supply all appropriate documents.

We also cannot supply some of the more detailed data requested because they would reveal the identity or holdings of an individual reporter, or an individual customer of a reporter. This is the case with respect to information relating to individual OPEC countries in the Middle East and in Africa. To avoid disclosing information that would reveal the accounts of these individual investors, Treasury groups data for the eight oil exporting countries in the Middle East and data for four oil producing countries in Africa in the tables which it publishes.

Avoidance of such disclosure is called for by the International Investment Survey Act and the Bretton Woods Agreements Act, under which these data are collected. Neither the Acts nor their legislative histories contain any suggestion that an exception to the confidentiality requirements is to be made for Congress. In statutes under which Congress has intended that it have access to information which is to be kept confidential according to the mandate of those statutes, Congress has explicitly indicated that intention. The opinion of Treasury legal counsel on this issue is appended to my testimony.

Conclusion

I welcome this opportunity to discuss in detail with the Subcommittee the application to OPEC countries of U.S. policy toward foreign investment in the United States. I have reached several conclusions in the course of my testimony:

-- that OPEC investments in the United States, while large in absolute terms, represent a small share of every category of foreign investment in the United States and an extremely small share of total investments, domestic and foreign, in this country;

-- that the interests of the OPEC investors themselves, and their clearly stated policies, suggest little likelihood that they would ever try to disrupt our economy or financial system by withdrawing their investments here;

-- that, if they did, we have ample defenses against actual disruption through the workings of the private banking system, existing legislation and cooperation from other major countries;

-- that it would not be in the national interest of the United States to deter OPEC investments in this country any more than it would be to deter investments from other countries, and hence we respect the desires of some OPEC countries to maintain confidential treatment for their investments here, as clearly authorized by U.S. law;

-- and that a reversal of these policies, whether by changes in law or in current practice, would clearly discourage foreign investment for no apparent public purpose.

Within this framework, we have supplied -- and will continue to supply -- the maximum amount of data which we are free to supply under current law.

I look forward to continuing to discuss these issues with you.

TABLE 1

Estimated Disposition of OPEC Investable Surplus
1974-1978
($, billions)

	1974[r]	1975[r]	1976[r]	1977[r]	1978
United States	13	9 1/2	12	9 1/4	1 3/4
of which					
Treasury securities					
Bills	(5.3)	(.5)	(-1.0)	(-.9)	(-1.0)
Bonds and notes	(.2)	(2.0)	(4.2)	(4.3)	(-1.5)
Other marketable U.S. bonds	(.9)	(1.6)	(1.2)	(1.7)	(.8)
U.S. stocks	(.6)	(1.7)	(1.8)	(1.4)	(.8)
Commercial bank liabilities	(4.2)	(.6)	(1.9)	(.4)	(.7)
Subtotal (banking and portfolio placements)	(11.2)	(6.3)	(8.1)	(7.0)	(- .2)
Other (including direct investment, prepayments on U.S. exports, debt amortization, etc.)	(1.7)	(3.2)	(4.2)	(2.3)	(2.0)
Euro-banking market	22 1/2	8	11	12	2 1/2
United Kingdom	7 1/2	1/4	-1	3/4	- 1/4
Other developed countries	6	7 3/4	8	8	6
Less developed countries*	6	7 1/4	7 1/2	8 1/2	4 1/4
Non-market countries	1/2	2	1 1/4	1 1/4	1/2
International financial institutions (including IMF oil facility)	3 3/4	4 1/4	1 3/4	1/2	- 1/2
TOTAL ALLOCATED	59 1/4	39	40 1/2	40 1/2	14 1/4
Estimated current account surplus	71	35 1/2	39 1/2	35 1/2	5
Adjustment for lag in receipt of oil revenues	-11 1/4	+1	-4 1/2	+3	+ 1
Estimated gross borrowings	1/2	4	8	10	15
Cash surplus plus borrowings	60 1/4	40 1/2	43	48 1/2	21
Discrepancy in estimates	1	1 1/2	2 1/2	8	6 3/4

* Includes grants, debt amortization and prepayments for imports
** Includes grants
NA Not available
r Revised

Office of International Banking
and Portfolio Investment
July 16, 1979

OIL-EXPORTING COUNTRIES' FOREIGN INVESTMENT IN THE UNITED STATES 1/
(Millions of Dollars)

	Capital Flows					Position
	1974	1975	1976	1977	1978	12/78 P
Portfolio Investment	11,847	7,967	10,982	7,348	473	42,041
U.S. Treasury securities	5,475	2,425	3,205	3,467	- 2,467	12,659
Treasury bills & certificates	5,280	458	- 1,044	- 852	- 958	3,277
Treasury bonds & notes	195	1,967	4,249	4,319	- 1,509	9,382
Other U.S. Government liabilities 2/ 3/	125	946	2,351	372	495	4,414
U.S. Government Agency Securities 4/	884	1,067	761	956	128	3,796
Corporate bonds	13	495	418	736	703	2,365
Corporate stocks	618	1,652	1,828	1,408	793	6,299
Commercial bank liabilities, n.i.e.	4,238	630	1,903	401	685	10,255
Non-bank liabilities 2/	494	752	516	8	136	2,253
Direct Investment	111	- 32	- 6	- 10	69	325
Total foreign investment 5/	11,958	7,935	10,976	7,338	542	42,366

n.a. not available
n.i.e. not included elsewhere
1/ Oil-exporting countries consist of OPEC plus Oman and Bahrain.
2/ Position consists of cumulative flows, 1972-1978, OPEC only.
3/ Liabilities to foreign official agencies associated with U.S. military sales contracts and other U.S. Government transactions.
4/ For all years, holdings are by foreign official institutions.

5/ Differs from total, line 1, table 1, because table 1 includes and this table excludes changes in U.S. assets abroad, such as amortization of OPEC debt.

Office of International Banking and Portfolio Investment
July 16, 1979

TABLE 3

PORTFOLIO INVESTMENT IN THE U.S. BY OIL-EXPORTING COUNTRIES AND MIDDLE EAST OIL-EXPORTING COUNTRIES 1/
(Millions of Dollars)

	Position at end of period						
	1973	1974	1975	1976	1977	1978	Apr. 1979 p
I. Oil-Exporting Countries							
Portfolio investment	3,424	15,271	23,238	34,220	41,568	42,041	39,379
U.S. Treasury securities	554	6,029	8,454	11,659	15,126	12,659	11,189
Treasury bills & certificates	393	5,673	6,131	5,087	4,235	3,277	3,405
Treasury bonds & notes	161	356	2,323	6,572	10,891	9,382	7,784
Other U.S. Government liabilities 2/ 3/	125	250	1,196	3,547	3,919	4,414	4,648 4/
U.S. Government agency securities 5/	n.a.	884	1,951	2,712	3,668	3,796	3,688
Corporate bonds	n.a.	13	508	926	1,662	2,365	2,298
Corporate stocks	n.a.	618	2,270	4,098	5,506	6,299	6,610
Commercial bank liabilities, n.i.e.	2,398	6,636	7,266	9,169	9,570	10,255	10,946
Nonbank liabilities	347 6/	841 6/	1,593 6/	2,109 6/	2,117	2,253	n.a.
II. Middle East Oil-Exporting Countries							
Portfolio investment	947	7,192	16,250	27,662	35,358	34,094	32,339
U.S. Treasury securities	81	2,373	5,674	9,766	13,484	10,846	9,523
Treasury bills & certificates	81	2,173	3,677	3,886	3,153	2,296	2,613
Treasury bonds & notes	0	200	1,997	5,880	10,331	8,550	6,910
Other U.S. Government liabilities 2/ 3/	114	256	1,178	3,493	3,869	4,328	4,565 4/
U.S. Government agency securities 5/	n.a.	884	1,951	2,712	3,668	3,796	3,688
Corporate bonds	n.a.	0	495	903	1,640	2,332	2,265
Corporate stocks	n.a.	518	2,167	3,970	5,360	6,141	6,461
Commercial bank liabilities, n.i.e.	567	2,544	3,678	5,474	5,826	5,127	5,837
Nonbank liabilities	185 6/	617 6/	1,117 6/	1,344 6/	1,511	1,524	n.a.

n.a. not available
n.i.e. not included elsewhere
p preliminary

1/ Oil-exporting countries consist of OPEC-member countries plus Bahrain and Oman. Middle East consists of Iran, Iraq, Kuwait, Qatar, Saudi Arabia, United Arab Emirates, Bahrain, and Oman.
2/ Position consists of cumulative flows from 1972 forward, OPEC only.
3/ Liabilities to foreign official agencies associated with U.S. military sales contacts and other U.S. Government transactions.
4/ Data as of March 1979.
5/ For all years, holdings are by foreign official institutions.
6/ Individual country data for oil-exporting countries in Asia and Africa not reported separately prior to 1977. Total "Other Africa" used to estimate data for oil-exporting countries.

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7/16/79

TABLE 4

OPEC CURRENT ACCOUNT
($ billion)

	1977	1978	Forecasts 2/ 1979	1980
Oil Exports Earnings 1/	135.9	129.2	181	205
Non-Oil Exports (f.o.b.)	9.3	10.1	11	13
Imports (f.o.b.)	-85.6	-100.6	-111	-137
Trade Balance	59.6	38.7	81	81
Services and private transfers, net	-26.6	-33.4	-36	-41
(of which net investment income)	(5.0)	(5.0)	(6)	(8)
Current Account Balance (ex. official transfers)	33.0	5.3	45	40
Official Transfers	2.0	3.3	3	2
Current Account Balance (inc. official transfers)	31.0	2.0	42	38
Current Account Position of OPEC:				
Countries in Surplus	37.2	15.9	46	43
Countries in Deficit	-6.2	-13.9	-4	-5

1/ Government take plus cost of production.
2/ The 1979 and 1980 forecasts include OPEC oil price increases announced through June 1979. The estimated July 1, 1979 average OPEC price is about $20.50. It is assumed in the 1980 forecast that the July 1, 1979 prices hold throughout the rest of 1979 and 1980.

TABLE 5

PERCENT OF FOREIGN AND TOTAL INVESTMENT ACCOUNTED FOR BY OIL-EXPORTING COUNTRIES 1/
(Percent)

(+ inflows, - outflows)	Capital Flows					Position 12/78	
	1974	1975	1976	1977	1978	Of Foreign Investment	Of Domestic Investment
Portfolio Investment	40	60	34	16	1	13	1
U.S. Treasury securities	134 3/	33	26	11	*	9	2
Treasury bills & certificates	140 3/	26	*	*	*	5	2
Treasury bonds & notes	64	35	48	19	*	14	1
Other U.S. Government liabilities 2/	42	62	52	30	18	30	30 5/
U.S. Government Agency Securities	97	117 3/	75	35	10	20	1
Corporate bonds	10	*	67	50	58		
Corporate stocks	68 4/	35	66	53	33		
Commercial bank liabilities, n.i.e.	19	*	16	5	3	10	1
Nonbank liabilities	26	138 3/	*	1	5	16	**
Direct Investment	2	*	*	*	1	1	***
Total foreign or all investment	35	50	30	14	1	12	2/3

n.a. not available
* Percent not calculated if outflows by all foreign countries or by oil-exporting countries.
** Less than ½ of 1%. *** on the order of 1/100 of 1% of total net worth of all U.S. firms.
1/ Oil-exporting countries consist of OPEC members plus Oman and Bahrain.
2/ Liabilities to foreign official agencies associated with U.S. military sales contracts and other U.S. Government transactions.
3/ Reflects net disinvestment by countries other than oil-exporting countries.
4/ Based on flows of $367 million; valuation adjustments of $251 million were not included in the percent calculation.
5/ No comparable liabilities to residents.

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7/16/79

ANNEX

Response to the Subcommittee's Questions

in the letter to Mr. Bergsten

of June 26, 1979

QUESTION: We request that you produce all documents responsive to my April 10, 1979 letter, barring any constitutional privileges prohibiting this disclosure. We request that you include in an appendix to your testimony the information and data asked for on page 1 through 3 of the April 10 letter, set forth in the manner and under the categories requested.

ANSWER: The Department has determined we are not in a position to supply the documents which fall into three categories: (1) information coll´cted pursuant to statutes which accord confidential treatment to such information; (2) classified material, and (3) sensitive foreign relations information and high level policy memoranda.

As indicated in Mr. Mundheim's letter dated May 4, 1979 to Congressman Rosenthal, the Department is prohibited from releasing information collected under the authority of the Foreign Investment Survey Act of 1976 or the Bretton Woods Agreements Act, if the information relates to the affairs of an individual or a customer of a reporter. These two statutes preclude the Department from disclosing this information for the reasons discussed in the attached memorandum dated October 13, 1978, from Russell Munk, Assistant General Counsel, to C. Fred Bergsten, Assistant Secretary for International Affairs.

With respect to requests for classified material, while the Department would like to assist the Subcommittee to the fullest extent possible, we cannot release such documents absent adequate assurances by the Subcommittee that complete confidentiality of these documents will be maintained. The Department has an obligation to insure that classified information which is disseminated outside of the Executive Branch is fully protected from unauthorized disclosure. Executive Order 12065 on National Security Information, issued by the President on June 28, 1978, provides as follows:

Section 4-103: Controls shall be established by each agency to ensure that classified information is used, processed, stored, reproduced, and transmitted only under conditions that will provide adequate protection and prevent access by unauthorized persons. (emphasis added)

More importantly, Section 4-105 specifically addresses the dissemination of information outside the Executive Branch as follows:

> Classified information disseminated outside the Executive Branch shall be given protection equivalent to that afforded within the Executive Branch. (emphasis added)

The third category of information includes memoranda which record sensitive communications with oreign governments and high level inter- and intra-agency policy deliberations. The documents recording government-to-government communications must be kept confidential in order not to impair our ability to carry on candid discussions with other countries. Release of such documents containing statements which were made by representatives of foreign governments with the expectation that they would be closely held could seriously damage our future relations with such governments. The balance of the documents which we are not supplying involve high level intra- and inter-agency policy deliberations. It would be inappropriate to release these documents since there is a clear need to protect communications between high policy officials and those who advise them. The deliberative process involved in the policy-making decisions of the Executive Branch must be free from outside scrutiny to insure candid, objective consideration of policy alternatives.

The Department would like to emphasize that we recognize the Subcommittee's oversight responsibilities in this area, and we would very much like to assist and cooperate with the Subcommittee, to the fullest extent possible without jeopardizing the confidentiality of information which continues to need protection.

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6
UNITED STATES GOVERNMENT

Memorandum

Department of the Treasury
Washington, D.C. 20220

TO : Assistant Secretary Bergsten

DATE: OCT 13 1978

FROM : Russell Munk *RM*

SUBJECT: Disclosure of Information Concerning Saudi Arabian Investments in the United States

Congressman James H. Scheuer, in his capacity as Chairman of the Subcommittee on Domestic and International Scientific Planning, Analysis and Cooperation (the "Subcommittee") of the House Committee on Science and Technology, has requested Treasury to provide the Subcommittee with detailed information on Saudi Arabian investments in the United States. In his request, Congressman Scheuer included a legal report dated July 18,1978 prepared by Richard Ehlke of the Congressional Research Service which supported the Congressman's request. We have considered the Congressional Research Service memorandum, but we disagree with its conclusion.

Information on Saudi Arabian Investments in the United States is collected and given confidential treatment pursuant to the International Investment Survey Act of 1976, 22 U.S.C. 3101 et. seq., (the "Survey Act"), and the Bretton Woods Agreements Act, 22 U.S.C. 286 et seq., (the "Bretton Woods Act"). You have asked for my opinion on the extent to which Treasury is precluded from providing such information to the Subcommittee by the Survey Act and the Bretton Woods Act.

I have concluded that these two Acts preclude Treasury from disclosing to Congress data obtained under their authority to the same extent that they preclude disclosure of such data to persons other than government agencies which are specifically authorized to obtain the data under the Acts. This conclusion is based on the fact that neither the Acts, nor their legislative histories, contain any indication that an exception to their confidentiality requirements, which are very stringent, was to be made for Congress.1/

1/I have not examined in this memorandum the general question of whether the request for information is within the scope of the Subcommittee's jurisdiction.

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

In statutes under which Congress has intended that it have access to information which is to be kept confidential according to the mandate of those statutes, Congress has explicitly indicated that intention and has placed certain restrictions on such access.

A. The Survey Act and the Bretton Woods Act

1. Survey Act

The general purpose of the Survey Act is to provide "clear and unambiguous authority for the President to collect information on international investment and to provide analyses of such information to the Congress."

More specifically, Subsection 4 (a) of the Survey Act provides that the President will: (1) conduct a regular data collection program; (2) conduct studies and surveys as may be necessary to prepare reports; (3) report periodically to the Committees on Foreign Relations and Commerce of the Senate and the Committee on International Relations of the House on developments with respect to laws and regulations affecting international investment and (4) publish for the use of the general public and United States Government agencies, statistical information collected pursuant to the subsection. Nothing in this subsection indicates that the reports and raw data from the reports will be used for purposes other than producing the statistics to be published pursuant to Subsection 4 (a)(4), or that the Executive Branch is required to provide these reports and raw data to Congress. The fact that in the Survey Act Congress explicitly required certain types of information be furnished to it and did not mention its access to data which it required be kept confidential indicates that it did not intend to receive the confidential data received from reporters under the Survey Act.

The Survey Act provides that information obtained from reporters (a) will be used only for analytical or statistical purposes within the United States Government ~~and~~ ~~(b)~~ ~~may~~ not be published ~~or made available~~ to any person in a manner that the person who furnished the information can be specifically identified. "Person" is defined in Section 3 (3) of the Survey Act to include "... any government (including a foreign government, the United States Government, a State or local goverment,

and any agency, corporation, financial institution, or other entity or instrumentality thereof, including a government-sponsored agency)." Thus, Congress is a "person" subject to the above-described limitations on disclosure of information.

Within the United States Government, access to the information is strictly limited to officials or employees designated to perform functions under the Survey Act. However, the President may authorize the exchange of such information between agencies or officials designated by him. Since the Congress is not an "agency" and since we believe that the "officials" who may be designated to receive information refers to officials of agencies, it is our view that the President could not designate Congress, its members and its staff as an "agency" or "officials" with whom the information could be exchanged. In any event, no such designation has been made by the Secretary of the Commerce, to whom the responsibility for designation has been delegated.2/

A person who reveals data that would identify a reporter to any person other than a person designated to perform functions under the Survey Act is subject to a criminal fine of up to $10,000. Given this strong expression of congressional concern about maintaining the confidentiality of the information obtained from reporters, it would be anomalous to find implicit in the Survey Act a congressional intent to make such information available to the Congress without any limitations.

2/ The disclosure provisions of the Survey Act are based on those of the Foreign Investment Study Act of 1974, Pub. L. 93-479, October 26, 1974. That Act provided in Section 7 that neither the Secretary of the Treasury nor any employee of either Department may:

"1) use any information furnished under subsection (b)(2) except for analytical or statistical purposes within the United States Government; or

"2) publish, or make available to any other person in any manner, any such information in a manner that the information furnished under subsection (b) (2) by any person can be specifically identified, except for the purposes of a proceeding under section 8."

Moreover, the Survey Act provides that "no person" can compel the submission or disclosure of any report or constituent part thereof, without prior written consent of the person who maintained or furnished such report and without the prior written consent of the customer, where the person who maintained or furnished such report

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2/(Continued from preceding page) In Senate floor debate, Senator Inouye explained several amendments he proposed to the bill as passed by the House. In amending Section 7, the Senator stated that:

"The second amendment, which amends subsection 7(c)(2), clarifies the intention of the Congress that the information gathered under subsection 7(b) may be furnished in an enforcement proceeding under section 8 even though a person can be specifically identified through the data. Ordinarily, data under this act can be released only in aggregate form."

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"The information gathered under this act may be used only for preparing analyses and statistical data within the sections responsible for studying foreign investment. Subsection 7(c)(2) prohibits the release of identifiable information to anyone outside the Government except in a court proceeding under section 8 of this act. Subsection 7 (d) protects the information from involuntary disclosure under court order or administrative subpoena other than a section 8 proceeding." 120 Cong. Rec. 34683-34684 (1974).

It is evident from this statement that Senator Inouye read the word "Government" as used in Section 7 of the 1974 Act to mean solely the Executive branch, since the statement referred to court proceedings as being "outside the Government." Congress carved out this single exception for court proceedings from the otherwise complete prohibition of disclosure of dis-aggregated data to persons outside the Executive branch. By applying the maxim expressio unius est exclusio alterius, it appears that the failure to make a similar exception to permit disclosure to the Congress suggests a Congressional intent that an additional exception not be implied for release of particularized survey data to the Congress. Adoption of generally similar language in the Survey Act of 1976 suggests that this interpretation is likewise applicable to the Survey Act.

included information identifiable as being derived from the records of such customer. Thus, a committee of the Congress --which would appear to be a "person" within the meaning of the Survey Act-- also lacks authority to compel disclosure of data except on the condition that the data not identify the reporter or customer of the reporter.

Finally, in Section 7(c) of the Survey Act, Congress stated, "Nothing in this Act is intended to restrain or deter foreign investment in the United States or United States investment abroad." The very strict confidentiality provisions of the Survey Act are in furtherance of this statement of intent. Saudi Arabia, which invests in the United States almost exclusively through the Saudi Arabian Monetary Agency (SAMA), would be deterred from investing in the United States were the details of SAMA investments in the United States to be disseminated to persons other than those espressly mentioned in the Survey Act. Saudi Arabian officials have stated on a number of occasions to high level Treasury officials the great importance they attach to having the details of SAMA's investments in the United States remain confidential. From a Saudi perspective, disclosure of the information to the Subcommittee could appear to be inconsistent with the requirement of confidentiality. Thus, it could result in a withdrawal of investments from the United States, causing a disruption in our relations with Saudi Arabia and thwarting U.S. policy to encourage productive investment of petrodollars. Such a result would be directly contrary to the express intention of Congress that nothing in the Survey Act is intended to restrain or deter foreign investment in the United States.

2. Bretton Woods Act

Section 8(a) of the Bretton Woods Act 22 U.S.C. 286f(a) provides that the President may require any person to furnish such data as the President may determine to be essential to comply with a request by the International Monetary Fund (IMF). Section 8 of the Bretton Woods Act expressly authorizes disclosure of the information collected only to the IMF. However, information acquired by the President under the section may not even be furnished to the IMF in a degree of detail that would disclose the affairs of any person

--either the reporter or its customers.3/ The purpose of the prohibition protecting the affairs of particular persons from disclosure when the data is used for its intended purpose of reporting to the IMF would be frustrated if the same data could be released to all entities other than the IMF in a manner that would disclose the affairs of the persons to whom they pertained.

Section 8(a) speaks in terms of limiting the amount of detail in the release of information only in the context of releases to the IMF, because the data collected pursuant to that section was expected to be released only to the IMF. Since it was not contemplated that that section would authorize the release of this data to any other entity, the issue of the extent of detail in releases to other entities would not arise.

Moreover, 22 U.S.C. 286f(c) provides that it shall be unlawful for any government officer, employee, consultant or adviser to disclose information obtained pursuant to Section 286f other than in the course of his "official duty." Violation of this provision is punishable by fine and imprisonment.

"Official duty" should, in our view, be construed to mean the duty imposed by Section 286f; i.e., to collect information, to analyze it and to summarize it in a form to be sent to the IMF. Any disclosure of data for purposes other than these and not authorized by the Federal Reports Act, (e.g. disclosing the information to the Congress) would fall outside the "duty" imposed by Section 286f, and would, consequently, be prohibited. This prohibition is qualified, however, to the extent that information is collected under the more recent Survey Act as well, because the Survey Act allows transfer of information to agencies or officials designated by the President.

3/ Treasury currently furnishes the IMF with aggregate data similar to that published in the Treasury Bulletin. However, in order to obtain this aggregate data, Treasury must collect disaggregated data from individual reporters. This raw data, together with certain country totals produced from this raw data, could reveal the affairs of individual reporters or their customers and for this reason is not published in the Treasury Bulletin or furnished to the IMF.

their customers and for this reason is not published in the Treasury Bulletin or furnished to the IMF.

A recent amendment to the Bretton Woods Act, Section 286k(b), requires the President, upon request of any congressional committee having legislative or oversight jurisdiction over monetary policy or the IMF, to furnish that committee with information obtained from the IMF, consistent with United States membership obligations in the IMF and subject to such limitations as are appropriate to the sensitive nature of the information. None of the data requested by the Subcommittee was obtained by the U.S. Government from the IMF. Conversely, Treasury has never released the data requested by the Subcommittee to the IMF. Of equal importance is the fact that the IMF does not receive from member states data of the type and detail requested by the Subcommittee. Thus, 286k(b) does not constitute authority for the Subcommittee to obtain from Treasury the data on Saudi Arabia which it seeks.4/

B. Opinions of the Attorney General

Congressional access to data gathered under confidentiality provisions of other statutes has been the subject of several opinions of the Attorney General. Most recently on September 8, 1978 the Attorney General opined that Section 301(j) of the Federal Food, Drug and Cosmetic Act, 21 U.S.C. 331(j) prohibits the disclosure to Congress of reports from drug manufacturers filed with the Department of Health, Education and Welfare under that Act. In 1975, the Attorney General opined that the Secretary of Commerce was precluded by the confidentiality provisions of the Export Administration Act of 1969, 50 U.S.C. App. 2406(c) from complying with

4/ That Congress made no attempt to require the Executive Branch to provide the Congress with information furnished to the IMF under Section 286f in no way implies that Congress already was entitled to such data. On the contrary, the fact that the Congress apparently felt it necessary to adopt Section 286k(b) in order to obtain access to the data furnished by the IMF, suggests that a similar provision would be necessary to grant it access to data furnished to the IMF.

a Congressional subpoena to produce reports filed with the Commerce Department under that Act.5/ Other opinions supporting the Executive Branch's withholding confidential information from Congress include:

- 27 Ops. A.G. 150 (1909), subpoena of Senate Judiciary Committee for confidential information held by the Commission of Corporations

- 41 Ops. A.G. 221 (1955), request of Senate Interstate and Foreign Commerce Committee for confidential information held by the Federal Communication Commission.

- 42 Ops. A.G. 485 (1974), request of House Judiciary Committee for tax return information.

All of these opinions have relied on the general rule that "... statutory restrictions upon executive agency disclosure of information are presumptively binding even with respect to requests or demands of congressional committees." (September 4, 1975 Attorney General's opinion issued to the Secretary of Commerce)

2. Other statutes

There are a number of other statutes where Congress has made its intent clear in legislation to have confidential information supplied to it. For example,

- The Internal Revenue Code contains a confidentiality provision limiting the disclosure of tax returns (26 U.S.C. 6103). That provision has an express exception allowing the Committee on Ways and Means, the Committee on Finance, the Joint

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5/ It should be noted that the statute at issue in this opinion permitted disclosure "in the national interest" and that the Secretary of Commerce utilized this statutory discretion by releasing portions of the requested material to Congress. The Survey Act and Bretton Woods are more absolute in their terms and allow no such discretion.

Committee on Taxation, the Chief of Staff of the Joint Committee on Taxation, and any other congressional committee authorized by the case of a joint committee, by a concurrent resolution to obtain access to any return upon request.

- The Civil Aeronautics Act (49 U.S.C. 1504) limits under certain conditions, the disclosure of information obtained from persons who are regulated under the Act. However, this confidentiality provision contains an express exception for Congress, which states ". . . nothing in this section shall authorize the withholding of information by the Board or Administrator from the duly authorized committees of Congress."

- The Atomic Energy Act expressly provides for the Joint Committee on Atomic Energy to receive information on all activities of agencies in the atomic energy field, notwithstanding a provision in the same Act severely limiting access to such data. (42 U.S.C. 2252).

- In the 1977 amendments to the Export Administration Act of 1969, Congress specified any information obtained under that Act "shall be made available upon request to any committee or subcommittee of Congress of appropriate jurisdiction. No such committee or subcommittee shall disclose any information obtained under this act which is submitted on a confidential basis unless the full committee determines that ~~the withholding~~ thereof is contrary to the national interest."

These and other statutes reveal that when Congress intends to give itself the right of access to information which it has statutorily mandated be kept confidential, Congress clearly indicates that intention in the legislation.

naming the committees which are to have access or otherwise specifying within each confidentiality provision procedures for determining which committees are to have access. The confidentiality provisions of the Survey Act and the Bretton Woods Act contain no exceptions to their confidentiality requirements which would permit the information requested by Congressman Scheuer to be given to any congressional committee.

QUESTION: We would like you to summarize these OPEC investment schedules (referred to above and to be included in your appendix). More specifically, we would like your testimony to cover, for each major OPEC investor, (Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Iran, and Venezuela), both the most recent and the December 31, 1974, dollar amount figures for those country investments in the United States, showing as to each country the investment in (1) U.S. Government securities, broken down by Treasury and non-Treasury securities; (2) Americ n bank liabilities, broken down by time deposits, demand deposits, and negotiable CDs; (3) state and local government bonds; (4) stocks; (5) bonds; and (6) portfolio investment in real estate.

ANSWER: Detailed data on U.S. investments by OPEC countries and by Middle East Oil Exporters are attached to my testimony. Data available to Treasury on holdings of U.S. Treasury securities do not permit separate identification of purchases through nominee/custody accounts or in the secondary market. The split between demand, time and savings deposits, and negotiable certificates of deposit as of end April, 1979, is as follows:

	All Oil Exporters	Mid East Oil Exporters
	($ millions)	
Demand Deposits	3,647	1,781
Time and Savings Deposits	2,014	514
Negotiable CDs	1,383	1,259

Treasury data do not permit us to identify separately purchases of securities issued by state and local governments. Such purchases by foreigners, however, should be negligible because of their low yields relative to after tax yields available to foreigners on other instruments.

Data reportable under the Treasury's International Capital Movements System on any investments or financing associated with real estate transactions can not be separately identified.

Data for individual Middle East Oil Exporting countries cannot be disclosed under the provisions of the International Investment Survey Act and the Bretton Woods Agreements Act. Data for Venezuela are attached.

Venezuela: Estimated Placements in United States
(Net placements (+) or withdrawals (-): in $ millions)

nking & Portfolio Security Placements	Cumulative 1974-April 1979	1974	1975	1976	1977	1978	April 1979
Long-term:							
Treasury Bonds & Notes	179	*	*	145	50	-55	39
Federal Agency Issues	-12	-	-	-	*	-12	-
Subtotal	167	*	*	145	50	-67	39
Other U.S. Bonds	20	2	10	*	-1	9	*
U.S. Stocks	40	3	2	16	18	11	-10
Long-term bank liabilities	9	13	2	1	-7	n.a.1/	n.a.1/
Total Long-term	236	18	14	162	60	--47	29
Short term:							
Treasury bills	1	51	240	106	-105	-283	-8
Other	1,949	1,894	-364	-300	-77	1,165 2/	-369 2/
Total Short-term	1,950	1,945	-124	-194	-182	882	-377
otal Placement in U.S. of which:	2,186	1,963	-110	-32	-122	835	-348
Treasury securities 3/	168	51	240	251	-55	-350	31
Bank deposits	1,958	1,907	-362	-299	-84	1,165	-369
Other private sector	60	5	12	16	17	20	-10

* Less than $500,000.

1/ Long-term bank liabilities not reported seperately after April 1978.
2/ Includes long-term bank liabilities.
3/ Includes Federal Agency Issues

Source: Treasury International Capital Reports, and
Federal Reserve 2502 S reports.

Treasury/OASP/EI/EIS

July 13, 1979

QUESTION: We would like you to break down the OPEC investments in stocks and bonds by industry sector, using the SIC 2 number code, for only the Middle East OPEC nations. (A country-by-country breakdown here is not required.)

ANSWER: The Treasury International Capital (TIC) reporting system does not provide the identity of domestic issuers of stocks and bonds in which foreign entities have invested. Therefore, the TIC data cannot identify the industry sectors of firms whose stocks and bonds Mid East oil exporting nations have purchased. Foreign holdings by industry will be collected in the benchmark survey of foreign portfolio investment in the U.S. presently underway and these data will be incorporated in the report we will submit to Congress. The results of this study will be available next year.

QUESTION: Please give the more recent Treasury projections for the 1979 OPEC investable surpluses, breaking it down by country. Also, please give the same projections for 1980, 1981, and 1982. Have these figures been computed to include the effects of the OPEC price increase expected this very week? (Please indicate in the appendix how those figures compare to those of FAC, IMF, CIEC.)

ANSWER: We do not forecast OPEC's investable surplus. We estimate the investable surplus only on an *ex post* basis. Our estimates through 1978 are attached to my statement. However, trends in the investable surplus are closely related to trends in the aggregate OPEC current account balance excluding official transfers. The major elements that distinguish the investable surplus from the current account balance are net borrowings by OPEC members and differences between payments and accrual accounting techniques. In a period of rising prices for oil, the current account balance will increase faster than the investable surplus due to payments lags for oil shipments.

I believe that our projections for the aggregate OPEC balance for 1979 and 1980 will give a good indication of the likely trend in the OPEC investable surplus. Our experience suggests that the projections will be useful as indicators of the rough order of magnitude of movements in the OPEC surplus but not as precise numerical estimates of the absolute size of the surplus. The underlying statistical data are not very precise.

Historical data must be revised frequently as new information is obtained. As is the case for many countries, particularly the developing nations, statistical collection procedures used by many OPEC countries are incomplete and inadequate, and produce data only with a considerable time lag and substantial margin of error. Some of the countries are revising collection procedures and over time more accurate data will become available. At present much of the trade data in fact are derived from exporter country data. For example, U.S. exports to OPEC have to be used as a proxy for OPEC imports from the U.S., recognizing that this practice can result in errors. It also requires estimation of the freight and insurance payments which are not included in export data.

Over time, we have learned that individual country projections are more variable, and therefore are not as useful as the aggregate OPEC estimates. Changes in the level of oil production, for example, among countries may leave the aggregate balance roughly unchanged while substantially altering the position of individual countries. While aggregate imports by OPEC have been fairly accurately projected, projections of the widely fluctuating import growth rates for individual countries have not been reliable.

Consequently, it is with these caveats that I am providing you our most recent estimates which are for 1979 and 1980. These projections do include our estimates of the OPEC price increases which OPEC announced during its June meeting. We estimate that the export weighted OPEC average price resulting from the June meeting will be about $20.50.

If the oil prices agreed upon at the June OPEC conference hold throughout the rest of 1979 and 1980, the OPEC current account balance (excluding official transfers) in 1979 is expected to increase to $45 billion, and then drop slightly to $40 billion in 1980, as compared to $5 billion in 1978. At current oil export volume and oil prices a rough rule of thumb is that each one percent increase in oil prices raises the balance by roughly $1 1/2 billion, annually. We have not at this time made any projections for 1981 and 1982, in light of all the uncertainties cited above.

We are not at liberty to disclose IMF and OECD forecasts which, in any event, are subject to the same weaknesses. We are unable to identify an "FAC". The CIEC was disbanded in 1977.

I

OPEC CURRENT ACCOUNT
($ billion)

	1977	1978	Forecasts 2/ 1979	1980
Oil Exports Earnings 1/	135.9	129.2	181	205
Non-Oil Exports (f.o.b.)	9.3	10.1	11	13
Imports (f.o.b.)	-85.6	-100.6	-111	-137
Trade Balance	59.6	38.7	81	81
Services and private transfers, net	-26.6	-33.4	-36	-41
(of which net investment income)	(5.0)	(5.0)	(6)	(8)
Current Account Balance (ex. official transfers)	33.0	5.3	45	40
Official Transfers	2.0	3.3	3	2
Current Account Balance (inc. official transfers)	31.0	2.0	42	38
Current Account Position of OPEC:				
Countries in Surplus	37.2	15.9	46	43
Countries in Deficit	-6.2	-13.9	-4	-5

1/ Government take plus cost of production.

2/ The 1979 and 1980 forecasts include OPEC oil price increases announced through June 1979. The estimated July 1, 1979 average OPEC price is about $20.50. It is assumed in the 1980 forecast that the July 1, 1979 prices hold throughout the rest of 1979 and 1980.

II
OPEC: CURRENT ACCOUNT BALANCES
($ billion)

	1977	1978	Forecasts 1979	Forecasts 1980
Algeria	-2.8	-3.4	-1.4	-1.6
Ecuador	- .3	- .3	- .2	- .3
Gabon	- .1	+ .1	.4	.4
Indonesia	- .1	-1.3	.5	.3
Iran	5.1	-1.4	2.8	5.8
Iraq	5.0	4.5	10.0	7.4
Kuwait	5.2	5.8	12.2	11.5
Libya	2.6	1.5	5.5	5.7
Nigeria	- .9	-3.4	.5	-1.6
Qatar	.5	.9	1.9	2.2
Saudi Arabia	16.7	2.8	8.9	4.8
UAE	4.1	3.5	6.0	7.2
Venezuela	-2.0	-4.1	-2.1	-1.8
Total	33.0	5.3	44.9	40.1

QUESTION: It appears that a significant amount of OPEC investment may be made through the financial or other institutions of other countries. For example, a review of several memoranda from Mr. Keyser to Mr. Karlik dealing with recent foreign purchases of Treasury securities reveals that investors from either the Netherlands Antilles or Switzerland or both often purchase or sell more Treasury securities than do OPEC nations. Their purchases seem out of proportion to the true wealth of their country's citizens. In fact, a Treasury document dated April 3, 1979, shows that Swiss investment in U.S. Government securities totals around $15 billion, several billion dollars more than all reputed OPEC investment in them, taken together.

Please therefore give estimates as to what dollar amount of Swiss, British, Bahamian, and Dutch Antilles investments in both U.S. Government securities and in other types of assets are indeed OPEC originated and owned investments? What are your estimates based on? If you do not have estimates, what attempts have been made to uncover the true origin of the investments made through other countries? How could the Federal Government, by legislation or otherwise, overcome the concealment of OPEC investments through other nations?

ANSWER: The question quotes "several" Keyser to Karlik memoranda as showing larger purchases or sales of Treasury securities by residents of Switzerland or Netherlands Antilles than by OPEC residents. We are unable to find any such indication in any of the five memoranda from Keyser to Karlik which were supplied to the Subcommittee.

Clearly some portion of the investments which are placed in the U.S. by residents of other major financial centers represents reinvestment of funds for the account of residents of third countries. Switzerland is one of the most commonly used centers for such reinvestments.

Based on the data available to the Treasury, which are summarized in the attached tables, we do not believe that - Treasury data grossly understate the amount of investments in the U.S. placed directly by OPEC residents or that placements by OPEC residents via either Switzerland or the Netherlands Antilles are very large. These centers handle funds from investors around the world and the total amount of such funds flowing through these countries to the United States is too small to represent significant OPEC investment activity. Moreover, the amount of most forms of Swiss and Netherlands Antilles portfolio investments in the U.S. has not increased from the levels that prevailed prior to 1974 when the investable surpluses by OPEC countries began to mount.

The data indicate, for example, that U.S. non-bank liabilities to Swiss residents are lower now than in 1972-73. Similarly Swiss purchases of private U.S. securities have been lower in recent years than in 1972-73.

We estimate that placements in U.S. banks by trust departments of Swiss banks for the account of all their customers are less than half the amount of total direct OPEC placements in U.S. banks. Placements through the trust departments of Swiss banks did jump sharply in 1974 and although the identities of the Swiss customers are unknown, it is reasonable to assume that some part of the increase was accounted for by OPEC residents. This mode of placing funds can be attributed at least in part to the uncertainties of OPEC investment practices at that time in the face of the sudden, massive influx of excess funds from oil exports. In 1975, the amount of these placements on behalf of customers of trust departments of Swiss banks declined sharply and after some growth in 1976 has remained level.

Placements in U.S. banks by all residents of the Netherlands Antilles have been extremely small and stable throughout the 1970's.

Purchases of U.S. Treasury securities by Swiss residents have fluctuated sharply in recent years. The most rapid increases in such purchases have occurred since 1977. These purchases have been almost entirely of short-term Treasuries and clearly reflect the turbulent exchange market events of this period.

Total foreign exchange holdings of Swiss monetary authorities as published in IMF's International Financial Statistics rose $7.5 billion during 1978. Although neither the Swiss nor the IMF publishes a breakdown of these assets by currency, there is little doubt that a very high percentage of this increase represented dollar purchases in the foreign exchange market and that a high percentage of these official dollar purchases were invested in U.S. government securities.

The Treasury does not believe that any useful purpose would be served by legislation designed to identify the country of origin of funds handled by international banking countries such as Switzerland. The United States does not have legislative power over the banking institutions of other countries. It would thus be necessary to register all foreign purchases of U.S. securities, requiring the buying institution to identify the nationality of the customer for whom it was acting. Such legislation

would be ineffective. Since most portfolio investors of whatever nationality, Americans included, wish to keep their private affairs private, such a registration requirement would divert funds away from U.S. markets, to the extent the regulations were not evaded by interposing nominees of different nationalities from those of the ultimate investor.

Swiss banking laws protecting customers' privacy would force Swiss bankers either to stop buying U.S. securities, or to buy the securities on non-U.S. exchanges from other foreigners. Such additions to the normal market friction of international transactions would impede the international securities markets and would damage the financial and economic interests of the United States.

Amount of Outstanding Liabilities Reported by U.S. Non-Banks to Switzerland and Netherlands Antilles ($ millions)

	1972	1973	1974	1975	1976	1977	1978
Switzerland	663	674	728	656	449	504	499
N. Antilles	28	12	34	64	37	46	50

Net Purchases (-Sales) of Long-Term Domestic Bonds by Swiss and Antilles Residents 1/ ($ millions)

	1972	1973	1974	1975	1976	1977	1978
Switzerland	135	333	96	117	155	94	-100
N. Antilles	-7	8	66	-3	34	-6	3

Net Purchases (-Sales) of U.S. Stocks by Swiss and Antilles Residents 1/ ($ millions)

	1972	1973	1974	1975	1976	1977	1978
Switzerland	642	685	36	899	-100	152	-585
N. Antilles	-35	-35	-13	-22	45	52	8

Estimated Outstanding Liabilities of U.S. Banks to Trust Departments of Swiss Banks ($ billions)

	1972	1973	1974	1975	1976	1977	1978
	N.A.	1 1/2	5 1/2	3 1/2	4 1/2	4 1/2	4 1/2

1/ Excluding U.S. Treasury notes and bonds.

QUESTION: We would like Treasury's position and views on (1) the benefits and desirability and (2) the risks and negative effects of OPEC investment.

ANSWER: These points are covered in the body of my testimony.

QUESTION: What are the ten industry sectors (SIC 2 number sectors) in which OPEC investors have invested the most in making portfolio investments? What have been the effects in each of these sectors? More particularly, what has been the impact on the companies involved in terms of technology transfer, repatriation of profits, local borrowings for business expansion and export generation? What studies or analyses has Treasury done in this area?

ANSWER: As noted in an earlier response, the TIC data do not identify the domestic issuers of stocks and bonds purchased by non-residents. Consequently, TIC data cannot identify the ten industry sectors which have received the largest amounts of OPEC portfolio investments.

In conjunction with the 1974 benchmark survey, an extensive analysis was conducted on the impact of total foreign portfolio investment in the U.S. on our economy and our capital markets. This analysis appears in the published report on the benchmark survey. After compilation of the data from the benchmark survey presently underway, this analysis will be updated and expanded as the data permit.

The Treasury has not undertaken studies of the micro-economic effects of foreign portfolio investment including the effects of such investments on technology transfers, repatriation of profits, local borrowings for business expansion and export generation. The data Treasury collects do not lend themselves to such analyses nor were they or the benchmark surveys intended for such use.

QUESTION: What OPEC investment is monitored by the Treasury Department and what is not monitored? How often is this (sic) data collected? What is the extent of OPEC portfolio investment in real estate?

ANSWER: Extensive data on portfolio transactions between the U.S. and residents of individual foreign countries, including each OPEC country, are regularly collected under the Treasury International Capital (TIC) Reporting System. The data are collected monthly, quarterly or semi-annually depending upon the form. Mandatory reports are filed with Federal Reserve Banks by commercial banks, bank holding companies, securities brokers and dealers and nonbanking concerns in the U.S., including the branches, agencies, subsidiaries and other affiliates in the United States of foreign f rms.

Some 500 banks file a combination of monthly, quarterly and semiannual reports (B series) on their liabilities to and claims on, foreign residents. The liabilities and claims, including those held for banks' domestic customers, are reported by major type of item and by type of foreign resident, i.e., foreign official institution, unaffiliated foreign bank, own foreign offices, and other foreign residents.

Banks, securities brokers and dealers, and in some instances, nonbanking concerns, submit monthly reports on their securities transactions (Form S) with foreign residents. Specifically covered are long-term domestic securities by type, i.e., Treasury bonds and notes, Agency issues, corporate bonds and stocks, and foreign stocks and bonds. Currently some 175 Forms S are filed monthly.

Detailed quarterly forms (C-Series) are filed by approximately 1,000 nonbanking concerns such as importers, exporters, industrial and commercial concerns and financial institutions other than banks and brokers. These reports cover the financial and commercial liabilities and claims by type, of nonbanking firms in the U.S. vis-a-vis unaffiliated foreign residents.

Foreign investment in U.S. real estate, i.e., purchases of land and buildings, are not within the purview of the TIC reporting system. Such transactions are considered to be direct investments. The international flow of capital arising from the financing of such an investment would, of course, enter into the banking statistics, but can not be identified separately. Foreign investment in U.S. real estate ventures evidenced by shares, etc., would be covered by Form S; however, these data are not collected by SIC categories and cannot be separately identified.

QUESTION: We would like a full and detailed explanation for the policy reasons behind the refusal to publish OPEC country data and to provide this (sic) data to GAO.

ANSWER: The statement discusses at length the legal and policy reasons for not p·blishing the data on the U.S. holdings of individual Mid East oil exporting countries, and for not supplying them to the GAO.

The question above cited the following passage in the GAO report: "If the policy reasons for either of these aggregations reflect concerns that disaggregation would reveal the specific holdings of a foreign central bank or monetary authority, the data which support these concerns should be made available under appropriate safeguards to the subcommittee and to us."

The following tables provide the data requested by the GAO report. They demonstrate that:

-- official institutions now account for the overwhelming bulk of the portfolio investments of each of the major Mid East Oil Producing Countries.

-- in contrast, prior to 1973-1974, private investors generally accounted for the majority of the portfolio investments by these countries in those instruments for which data were collected.

Portfolio Transactions in the U.S. by Official Institutions of Mid East Oil Exporters 1/ as Proportion of That Country's Total Transactions

I. Outstanding Liabilities Reported by U.S. Banks and Brokers Including U.S. Treasury Bills Held in Custody

	End 1973 Percent Official			End 1978 Percent Official			
	0-35	35-50	50-65	50-60	60-70	70-80	80-100
Average for All Mid-East Countries		X				X	
Country A	X			X			
Country B	X						X
Country C			X				X
Country D	X					X	
Country E		X			X		

II. Net Transactions in U.S. Securities

	Fourth Quarter 1974 2/		1978		
	0	90-100	0	70-90	90-100
Average for All Mid-East Countries		X			X
Country A	3/			X	
Country B		X			X
Country C	3/				X
Country D	3/			3/	
Country E	3/				X

1/ Countries covered are Iran, Iraq, Kuwait, Saudi Arabia, UAE.
2/ Data on official holdings not collected prior to September 1974.
3/ Transactions of all residents of the country or official transactions were de minimus.

QUESTION: Your April 18 letter relies heavy on statistical reasons for nondisclosure, that reason is belied by other statements and facts.

First, in your April 19 letter, you state:

"...Over the years, some of the OPEC Governments which have expressed concern over possible disclosure of the details of their investment in the United States have been told of this treatment."

Second, the former Secretary of the Treasury, William Simon, and an assistant of his, told GAO there were policy reasons for withholding OPEC country information, which started in 1974. As stated in the GAO report:

"Other sources whom we interviewed, including the former Secretary of the Treasury, stated that information on specific OPEC countries is not held confidentially for statistical or legal reasons. Rather, they assert that the Treasury Department had made special commitments of financial confidentiality to Saudi Arabia and perhaps other OPEC governments. Part of these agreements was an understanding that OPEC statistics would be reported by region in exchange for Saudi Arabian purchases of U.S. Government securities. According to Department sources, OPEC nations told the Treasury Department and the Federal Reserve Board that OPEC money would not be put in the United States without a pledge of confidentiality. The Treasury Department denies that such promises were made to OPEC nations. Treasury maintains that OPEC countries receive no special treatment."

ANSWER: We have not denied that there are policy reasons for withholding data on assets of individual OPEC countries. There are both policy and legal reasons. My statement describes the policy reasons in detail.

We have also not denied that some OPEC countries were promised that the confidentiality of their accounts would be respected. What we do deny is that any pledge of confidentiality - by this Administration, at least - was contingent on some investment commitments by OPEC countries. Treasury officials gave assurances that confidentiality would be respected and made clear that OPEC investments - particularly in U.S.G. securities - would be welcome. It became apparent that if certain OPEC governments invested in the U.S. in the magnitudes contemplated, maintenance of confidentiality and adherence to the legal requirement of the Bretton Woods Agreements Act would necessitate a change in U.S. statistical presentation. The change was made to maintain the principle - not to give a protection which had not previously been provided.

The assurances that confidentiality would be respected did not constitute preferential treatment. Confidentiality was at that time, as now, available to all investors in the U.S. To have asserted that the principle of confidentiality would only be respected if individual OPEC governments instituted special investment programs would have been to threaten discrimination against such investors.

My letter of April 19 may inadvertently have been misleading in one respect which I greatly regret. Treasury has not maintained a procedure for continuing review of its statistical presentation to assure that in no case did the holdings of a particular central bank or government come to constitute a percentage of the total high enough to approach the target of generally used disclosure tests. It is our understanding that, when established, the disaggregations were believed to avoid any such problems. As I have pointed out in my statement, investment patterns have changed greatly over the past 10 to 15 years and the bulk of foreign holdings of U.S. securities are held by official institutions globally and, obviously, in a number of individual countries. Thus in the absence of complaints we have continued the detailed presentation. Should any country request a change to preserve the confidentiality of its holdings we would feel obligated - by the law as well as policy - to make such a change. This is why we consider that the treatment afforded OPEC countries is not preferential.

QUESTION: The assertion that no promises were made is contradicted by statements in a memo to you from Lisle Widman, re: "Talking Points for Use with Mr. Scheuer Re Saudi Investments in U.S.", with a written date of August 17, signed by the initiator, J. M. Newman. In that memo, Mr. Widman states:

> "7. We believe it is essential that we continue not to release such data. Many foreign governments, including those in the Middle East, consider this to be a sensitive, private matter. Some of the Middle East governments have told us frankly that should information on their financial position (sic) be released, they would consider this to be a most serious breach of confidence, requiring changes in their investment policies in favor of countries which are able to be discreet. Such action, apart from legal considerations, could, therefore, result in depriving the U.S. capital market of an important source of funds and lead to increase in the cost of funds to the U.S. for the external financing of our current account deficit.

"8. Release of data on the assets of Saudi Government could have even more extensive, dangerous implications. We could well lose the cooperation of the Saudis as a moderating force both on financial and energy questions."

ANSWER: The U.S. has indicated to the governments of several Middle East oil-exporting countries that the confidential treatment of their investments in the United States would be continued. Maintenance of this confidentiality is not, however, contingent on any pledge by any government with respect to investment in the United States.

QUESTION: In view of all of the above, it appears that some form of understanding, promise, agreement, or arrangement, unilateral or otherwise, does exist between one or more OPEC nations and the United States. Accordingly, we would like to know the details of any such understandings, promises, agreements, or arrangements and the approximate date and nature of such discussion, referred to in the above passages, between Treasury official(s) and Middle East OPEC governments. We would also like information on (1) what these governments told Treasury about the specific consequences resulting from publishing these data and (2) the governments involved.

ANSWER: The previous responses indicate the nature of the assurances provided OPEC countries regarding disclosure of data on their investments in the U.S. Treasury files do not contain records of all of the conversations in which this matter could have been discussed between representatives of OPEC governments and high-level Treasury officials, especially in previous Administrations. A search of our files has identified a number of classified documents containing material of relevance, especially a number of memoranda of conversations with officials of OPEC countries which occurred since 1973. The implications of changes in current procedures for publishing these data are discussed in my statement.

QUESTION: Is OPEC direct investment, particularly Arab direct investment, dependent on such secrecy and does its importance to the U.S. economy justify this preferential treatment of withholding investment information from the public?

ANSWER: Most investors, both here and abroad, want to maintain some degree of confidentiality in their business transactions. We have had no indication that individuals from the OPEC countries who make direct investments here are any more or less sensitive about this than investors in other countries or here in the United States.

OPEC direct investments in the United States are not and never have been given preferential treatment. The Commerce Department has given the Subcommittee a breakdown by country of OPEC direct investment in the U.S.

QUESTION: Also, in the appendix to your testimony, please explain the recent efforts and work done within the Treasury Department to monitor international lending (usually of petrodollars) by American banks to LDCs. For example, in 1975, Treasury formed a working group under the direction of Lisle Widman. However, a review of the documents produced show that nothing has been done since then. Is this accurate? If not, please detail what has been done and produce any studies, research efforts, or reports. Also, please produce whatever documents this 1975 working group produced.

ANSWER: In the aftermath of the 1973/74 oil price increase, the aggregate current account deficits of developing countries rose dramatically. The bulk of the financing for these deficits was arranged through private markets largely in the form of relatively short-term commercial bank borrowings (especially trade credits). In 1974/75 the Treasury Department initiated a review of existing data sources on U.S. bank lending activity and decided that additional data would be useful in ascertaining both the exposure of American banks to LDCs and the rising debt burdens of the LDCs themselves.

The Office of the Comptroller of the Currency (OCC), the Federal Reserve and the FDIC developed a new reporting system as a result of this review. The new system focuses on outstanding loans, both by maturity remaining on the loan and by ultimate country of risk. This effort has enabled a closer monitoring of the activity of American banks as a group, not only in regards to their lending to LDCs but to all foreign countries.

The latest survey is attached.

In addition, the Federal Reserve significantly expanded the amount of data it collects on the foreign branch activity of U.S. banks. These new data provide an extensive data base for monitoring U.S. bank activities. The new information available from the U.S. is now being combined with improved data from the other major industrial countries, and quarterly reports on foreign lending by banks headquartered in these countries which are now published by the Bank for International Settlements.

While the Office of International Banking in Treasury follows bank lending on a global basis, the Office of Developing Nations Finance is concerned with all lending to LDCs, both individually and as a group. Since the 1973/74 oil-price increases, considerable effort has been devoted to analyzing financial flows to the LDCs as a group. The results of this effort are reflected in the annual Treasury reports to Congress on LDC debt that were submitted pursuant to Section 634 of the Foreign Assistance Act of 1961 (as amended) in 1975 through 1978. As a result of amendments to the Foreign Assistance Act last year, this information is now submitted by the Development Coordination Committee as part of the annual foreign assistance report to Congress. Treasury had primary responsibility for producing the information on debt and financial flows that appeared in last January's annual report.

At the individual country level, the Office of Developing Nations Finance is continually involved in monitoring the lending activities of U.S. banks. Country economists in this office meet with their counterparts in other agencies to exchange information about individual countries. They also regularly exchange views with representatives of international organizations and U.S. financial institutions. Treasury Attaches in Brasilia, Jidda and Mexico City are able to report in detail on major banking developments, and considerable information about bank lending is contained in the cable traffic from our Embassies around the world.

The Treasury Department is especially concerned about bank lending in countries experiencing debt-servicing problems. In the process of making policy decisions related to these situations, such as participation in debt-rescheduling exercises, Treasury economists seek information about lending from all possible sources, including the banking community itself. The objective is to ensure both that steps are taken to minimize losses for all creditors as a group and that all creditors share equitably in any losses that may occur.

We have been unable to identify the working group to which the question refers.

Joint News Release

Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board

June 21, 1979

COUNTRY EXPOSURE LENDING SURVEY

The results of a survey of foreign lending by large United States banks as of December 31, 1978, were made public today by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board. The data cover claims on foreign residents held by all domestic and foreign offices of 129 U.S. banking organizations with significant foreign banking operations.

The results indicate that cross-border and nonlocal currency claims increased moderately in 1978 rising 12 percent from $194 billion to $217 billion. Most of the growth represented increased claims on banks, which are largely related to money market activities. Cross-border and cross-currency lending to public and private nonbank borrowers increased by only $2 billion during the year. In addition, the survey indicates that local currency lending to local borrowers by foreign offices of U.S. banks increased $9 billion in 1978 to a total of $58 billion. Most of the increase in both types of lending occurred in the second half of the year.

Types of Loans

The survey concentrated on data involving lending from a bank's offices in one country to residents of another country or lending in a currency other than that of the borrowers. These are known as cross-border and cross-currency loans.

Cross-border and cross-currency loans are those most closely associated with country risk. As shown in Table I, such claims totaled $217

billion at year-end 1978. Claims on residents of Switzerland and the Group of Ten (G-10) developed countries represent 42 per cent of this total. Another 21 per cent represents claims on residents of "other developed countries" and "offshore banking centers."1/ Claims on residents of developing countries that are not oil exporters amount to 24 percent.

In addition, the banks reported $58 billion in local currency claims that were held by their foreign offices on residents of the country in which the office was located. An example would be Deutsche mark claims on German residents held by the German branch of the reporting U.S. bank. To a large extent, these local currency claims were matched by $48 billion in local currency liabilities due local residents.

Maturities

More than two-thirds of the reported cross-border and cross-country claims had a maturity of 1 year or less. Only $16 billion in claims had a maturity in excess of 5 years. Short-term claims are especially prominent in the G-10 countries and the offshore banking centers where a large volume of interbank lending takes place. Such placements of deposits are usually for very short periods.

For most other groups of countries, short-term claims accounted for slightly less than half of the total claims, although the proportion varied among countries.

Type of Borrower

Business with other banks accounted

1/ Countries where multinational banks conduct a large international money market business.

for the largest amount, equaling $116 billion. Most of the claims on banks were on those located in the G-10 countries and the offshore banking centers. Private nonbank sector lending totaled $62 billion, and loans to the public sector amounted to $39 billion. This last category includes foreign central governments, their political subdivisions and agencies, foreign central banks, and commercial nonbank enterprises owned by government. The distribution by type of borrower varied significantly from country to country.

Guarantees

Table II provides information on the cross-border and cross-currency claims that are guaranteed by residents of another country. Claims are reallocated from the country of residence of the borrower to another country in two major ways. First, claims on a bank branch located in one country where the head office is located in another country are allocated to the country of the head office. Since a branch is legally a part of the parent, claims on a branch are treated as being guaranteed by the head office. Second, claims on a borrower in one country which are formally guaranteed by a resident of another country are allocated to the latter country. These reallocations are thought to provide a better approximation of country exposure in the banks' portfolios than the unadjusted figures.

The results of the reallocations appear in the last column of Table II. Most of the shifts are accounted for by the transfer of claims on branches (and, where guaranteed, subsidiaries) of banks to their head offices ($41 billion out of $53 billion). In general, the reallocations primarily affected the offshore banking centers and some of the developed countries. For example, claims on the offshore banking centers decreased from $26 billion to $7 billion

and claims on the United Kingdom decreased from $35 billion to $16 billion. For most less developed countries, a relatively small portion of claims is externally guaranteed. The total shown for claims on foreigners by country of guarantor is about $196 billion or $21 billion less than the total for claims by country of borrower. This results from U.S. residents guaranteeing about $26 billion in claims on foreign residents and foreigners guaranteeing about $5 billion in claims on U.S. residents.

Commitments to Provide Funds for Foreigners

The survey also provided information on contingent claims on foreigners. The banks were asked to report only those contingent claims where the bank had a legal obligation to provide funds. As shown in Table III, the amounts reported total $60 billion, 73 percent of that total being on the private sector, including banks. Table III also adjusts these commitments for guarantees in the same manner as Table II does for claims.

TABLE I CROSS-BORDER AND NON-LOCAL CURRENCY CLAIMS BY RESIDENCE OF BORROWER: DECEMBER 1978
(IN MILLIONS OF DOLLARS)

COUNTRY	TOTAL CLAIMS	CLAIMS ON: BANKS	PUBLIC BORROWERS	OTHER PRIVATE	MATURITY DIST. OF CLAIMS: ONE YEAR AND UNDER	OVER ONE TO 5 YEARS	OVER 5 YEARS
G-10 AND SWITZERLAND							
BELGIUM-LUXEMBOURG	6693.8	6139.7	85.2	468.7	6374.0	261.9	57.8
CANADA	6458.8	3808.5	1232.3	1418.0	4676.7	938.7	843.2
FRANCE	9148.6	7131.9	971.3	1045.4	7125.5	1447.2	575.9
GERMANY, FEDERAL REPUBLIC OF	5274.0	2304.6	157.3	2812.0	4263.7	930.0	80.0
ITALY	5744.8	3271.3	1681.1	792.2	3875.7	1639.7	227.9
JAPAN	14507.2	8976.0	114.2	5416.9	11799.7	2396.3	310.1
NETHERLANDS	3611.8	2773.4	10.6	827.6	3115.0	396.3	100.4
SWEDEN	2195.4	1010.9	315.8	868.7	1259.3	621.6	314.7
SWITZERLAND	3129.9	2141.7	48.2	940.5	2895.4	181.4	52.9
UNITED KINGDOM	35280.0	26581.7	1667.3	7031.0	29055.3	4526.6	1698.1
TOTALS	92044.9	64140.1	6283.6	21621.4	74440.7	13340.0	4261.6
NON G-10 DEVELOPED COUNTRIES							
AUSTRALIA	1597.5	391.9	127.8	1077.7	709.2	602.2	285.1
AUSTRIA	1122.0	958.3	80.6	83.0	995.3	79.1	47.6
DENMARK	2182.1	764.7	526.9	890.5	1145.5	832.0	204.5
FINLAND	1363.7	434.5	406.7	522.3	[illegible]3.8	545.3	214.4
GREECE	1918.7	322.6	607.9	988.1	803.4	844.7	270.4
ICELAND	129.2	12.5	81.8	34.9	29.7	69.5	30.0
IRELAND, REPUBLIC OF	709.0	94.5	339.5	275.0	291.9	291.4	127.1
NEW ZEALAND	296.1	14.9	62.0	218.9	107.1	148.2	40.7
NORWAY	2199.0	242.9	166.0	1790.1	737.9	931.9	529.1
PORTUGAL	594.4	427.1	102.9	64.3	477.0	72.4	44.8
SOUTH AFRICA	2304.1	377.3	775.8	850.8	1194.1	725.0	85.0
SPAIN	3478.2	1164.8	766.4	1547.7	1696.3	1494.4	287.0
TURKEY	1582.6	991.9	432.6	158.0	1224.3	312.3	46.0
OTHER	227.4	48.3	33.0	146.1	122.0	92.3	11.1
TOTALS	19404.5	6246.9	4510.2	8647.9	10138.2	7041.3	2223.3
EASTERN EUROPE							
BULGARIA	590.6	370.6	178.1	42.0	302.6	264.1	23.9
CZECHOSLOVAKIA	172.9	151.0	16.5	5.4	126.4	44.5	2.0
GERMAN DEMOCRATIC REPUBLIC	1151.0	696.8	363.2	90.9	551.0	580.1	18.2
HUNGARY	827.1	243.7	577.4	6.0	381.7	376.8	66.4
POLAND	1315.2	670.8	440.9	203.4	498.7	735.3	81.1
ROMANIA	323.3	172.5	134.8	15.9	220.3	92.0	11.0
U.S.S.R.	1185.8	747.3	363.3	75.0	475.4	618.1	92.1
YUGOSLAVIA	1629.8	763.7	234.6	631.5	505.7	972.1	152.0
TOTALS	7196.0	3816.7	2309.1	1070.3	3062.2	3683.2	447.0
OIL EXPORTING COUNTRIES							
ALGERIA	1829.9	427.8	1111.0	290.9	434.2	1081.4	314.2
ECUADOR	1560.5	251.9	696.9	611.7	834.4	497.7	228.2
GABON	224.6	3.6	206.8	14.2	51.7	154.1	18.8
INDONESIA	2215.4	369.8	921.6	924.0	959.5	915.4	340.5
IRAN	2625.6	1276.3	944.9	404.3	1241.1	1104.8	279.5
IRAQ	155.4	35.9	37.5	82.0	123.8	31.6	.0
KUWAIT	779.1	599.0	1.8	178.3	723.6	55.2	.3
LIBYA	138.7	133.5	5.0	.2	138.7	.0	.0
NIGERIA	618.5	174.1	357.7	86.6	220.1	282.7	115.6
QATAR	175.8	12.3	112.4	51.2	28.2	87.9	59.7

COUNTRY	TOTAL CLAIMS	----------CLAIMS ON:---------- BANKS	PUBLIC BORROWERS	OTHER PRIVATE	--MATURITY DIST. OF CLAIMS:--- ONE YEAR AND UNDER	OVER ONE TO 5 YEARS	OVER 5 YEARS
OIL EXPORTING COUNTRIES							
SAUDI ARABIA	917.5	363.0	47.6	506.9	796.1	107.4	9.9
UNITED ARAB EMIRATES	1276.9	474.3	533.0	269.6	794.7	376.5	106.7
VENEZUELA	7528.9	1338.1	3220.6	2970.4	5102.4	1966.0	460.4
TOTALS	20047.3	5459.9	8197.1	6390.6	11449.0	6661.2	1934.1
NON-OIL EXP DEV COUNTRIES-LATIN AM & CARIBBEAN							
ARGENTINA	2752.5	690.3	1041.2	1021.0	1479.4	1085.6	187.5
BOLIVIA	590.1	83.4	291.9	214.7	303.8	254.4	31.8
BRAZIL	13438.1	4909.3	3109.7	5419.0	4719.3	6728.4	1990.3
CHILE	1527.0	548.6	550.4	427.8	727.3	690.3	109.4
COLOMBIA	1497.2	513.4	483.1	500.6	1023.6	403.2	70.2
COSTA RICA	432.8	47.1	160.5	224.9	245.5	151.2	35.9
DOMINICAN REPUBLIC	386.2	66.1	230.5	89.5	248.4	108.8	28.9
EL SALVADOR	316.7	75.5	64.4	176.8	239.1	51.6	25.9
GUATEMALA	241.4	6.4	27.1	208.0	128.8	109.0	3.7
HONDURAS	312.5	61.5	95.6	155.3	171.9	108.1	32.4
JAMAICA	229.3	17.1	169.6	42.6	83.4	128.2	17.6
MEXICO	10657.3	2557.3	4418.7	3681.0	4500.7	4615.1	1541.4
NICARAGUA	571.7	208.3	231.3	132.0	419.2	129.5	23.0
PARAGUAY	84.8	14.2	42.7	27.9	42.9	16.2	25.7
PERU	1664.7	515.8	921.0	227.9	988.2	576.7	97.7
TRINIDAD AND TOBAGO	87.2	9.0	75.1	3.1	47.1	32.6	7.4
URUGUAY	150.8	20.5	51.2	78.9	99.6	37.5	13.7
OTHER	590.0	539.2	30.8	19.9	561.2	25.2	3.6
TOTALS	35531.2	10883.8	11995.6	12651.5	16[illegible]0.1	15252.3	4246.4
NON-OIL EXP DEV COUNTRIES-ASIA							
CHINA, REPUBLIC OF TAIWAN	3315.8	1282.7	866.9	1166.2	2339.8	877.2	98.4
INDIA	265.8	81.2	82.5	101.6	129.5	114.3	22.0
ISRAEL	1096.5	794.2	154.7	147.4	895.6	172.2	28.6
JORDAN	140.0	14.9	108.2	16.9	30.7	70.9	38.3
KOREA, SOUTH	3802.3	2032.7	508.3	1261.1	2782.9	824.5	194.9
MALAYSIA	537.1	92.1	292.0	152.9	208.0	152.2	176.9
PAKISTAN	106.0	44.9	29.3	31.8	58.6	47.1	.3
PHILIPPINES	2852.6	927.2	609.9	1315.2	1837.5	663.4	351.6
SYRIA	6.9	1.7	.0	5.2	3.9	3.0	.0
THAILAND	1235.9	856.3	155.4	224.1	1023.7	149.3	60.8
OTHER	388.1	110.4	89.1	189.6	201.8	171.3	15.2
TOTALS	13747.3	6238.7	2896.6	4611.3	9512.3	3245.7	987.2
NON-OIL EXP DEV COUNTRIES-AFRICA							
CAMEROON	62.1	4.2	54.9	3.0	11.3	46.7	4.1
EGYPT	565.1	390.5	107.8	66.6	470.1	82.9	12.0
GHANA	65.1	1.6	48.5	15.1	52.0	3.0	10.1
IVORY COAST	418.9	42.7	315.5	60.5	140.7	241.5	36.5
KENYA	59.0	1.0	30.7	27.3	28.2	29.2	1.6
MALAWI	77.3	9.4	64.7	3.2	34.5	37.3	5.5
MOROCO	597.7	84.4	475.5	37.7	138.4	395.6	63.8
SENEGAL	66.4	1.1	58.1	7.2	17.0	45.9	3.5
SUDAN	196.1	30.0	153.6	12.4	120.5	68.3	7.2
TUNISIA	203.7	10.6	171.5	21.6	41.5	136.9	25.2

TABLE I CROSS-BORDER AND NON-LOCAL CURRENCY CLAIMS BY RESIDENCE OF BORROWER: DECEMBER 1978

(IN MILLIONS OF DOLLARS)

COUNTRY	TOTAL CLAIMS	CLAIMS ON: BANKS	PUBLIC BORROWERS	OTHER PRIVATE	MATURITY DIST. OF CLAIMS: ONE YEAR AND UNDER	OVER ONE TO 5 YEARS	OVER 5 YEARS
NON-OIL EXP DEV COUNTRIES-AFRICA							
ZAIRE	242.6	3.7	232.7	6.3	112.6	92.8	36.2
ZAMBIA	140.7	10.5	113.6	16.6	97.7	40.8	.3
OTHER	230.0	51.4	112.7	65.8	146.2	66.4	17.3
TOTALS	2925.1	641.2	1940.3	343.5	1411.1	1287.6	223.4
OFFSHORE BANKING CENTERS							
BAHAMAS	9012.2	8524.3	21.3	467.6	8547.2	185.1	281.2
BAHRAIN	1208.3	1102.9	8.0	97.4	1157.5	15.9	35.0
BERMUDA	556.3	15.1	3.0	538.2	399.2	103.5	53.5
BRITISH WEST INDIES	4446.3	4396.1	4.2	45.8	4396.3	47.9	2.0
HONG KONG	2396.5	1031.3	39.4	1325.7	1712.8	513.7	169.9
LEBANON	119.6	47.1	1.0	71.5	90.5	29.1	.0
LIBERIA	2217.1	23.6	83.7	2109.8	541.2	1107.7	568.2
MACAO	.9	.9	.0	.0	.9	.0	.0
NETHERLANDS ANTILLES	401.7	78.4	1.4	321.9	236.5	154.5	10.7
PANAMA	2885.7	1504.5	286.8	1094.4	2053.4	602.8	229.2
SINGAPORE	2766.9	2282.2	90.9	393.5	2588.3	115.1	63.4
TOTALS	26011.8	19006.7	539.9	6466.1	21724.2	2875.5	1413.2
INTERNATIONAL & REGIONAL ORGANIZATIONS							
AFRICAN REGIONAL	3.5	.0	3.5	.0	1.3	1.2	1.0
ASIAN REGIONAL	2.4	.0	2.4	.0	.0	1.4	1.0
E. EUROPEAN REGIONAL	113.1	.0	113.1	.0	46.2	65.6	1.3
INTERNATIONAL	196.9	.0	196.9	.0	8.3	137.6	51.0
LATIN AMERICAN REGIONAL	25.8	.0	25.8	.0	1.3	19.7	4.9
MIDDLE EASTERN REGIONAL	.0	.0	.0	.0	.0	.0	.0
W. EUROPEAN REGIONAL	91.1	.0	91.1	.0	.7	17.3	73.1
TOTALS	432.8	.0	432.8	.0	57.8	242.8	132.3
**** GRAND **** ** TOTALS **	217341.3	116434.3	39105.5	61803.1	147825.9	53630.0	15868.8

TABLE II CROSS-BORDER AND NON-LOCAL CURRENCY CLAIMS ON FOREIGNERS BY COUNTRY OF GUARANTOR: DECEMBER 1978
(IN MILLIONS OF DOLLARS)

COUNTRY	TOTAL CLAIMS (BY RESIDENCE)	CLAIMS GUARANTEED BY RESIDENTS OF OTHER COUNTRIES ON BANKS	CLAIMS GUARANTEED BY RESIDENTS OF OTHER COUNTRIES ON OTHERS	TOTAL CLAIMS LESS GUARANTEED CLAIMS	CLAIMS ON RESIDENTS OF OTHER COUNTRIES GUARANTEED BY RESIDENTS OF THIS COUNTRY ON BANKS	CLAIMS ON RESIDENTS OF OTHER COUNTRIES GUARANTEED BY RESIDENTS OF THIS COUNTRY ON OTHERS	TOTAL CLAIMS BY COUNTRY OF GUARANTOR
G-10 AND SWITZERLAND							
BELGIUM-LUXEMBOURG	6693.8	2059.1	257.4	4377.2	262.0	389.6	5028.9
CANADA	6458.8	339.0	330.9	5789.0	3604.6	517.4	9911.1
FRANCE	9148.6	1179.2	139.1	7830.3	2659.4	766.4	11256.2
GERMANY, FEDERAL REPUBLIC OF	5274.0	438.4	360.2	4475.3	3545.9	831.0	8852.2
ITALY	5744.8	192.0	200.8	5351.9	645.3	265.0	6262.3
JAPAN	14507.2	542.9	174.2	13790.1	4894.3	1429.8	20114.3
NETHERLANDS	3611.8	230.8	219.7	3161.2	726.9	261.2	4149.5
SWEDEN	2195.4	17.0	66.1	2112.3	174.1	175.0	2461.5
SWITZERLAND	3129.9	213.9	260.4	2655.5	1587.8	443.4	4686.8
UNITED KINGDOM	35280.0	17280.9	1569.2	16429.8	1079.9	774.9	18284.6
TOTALS	92044.9	22493.5	3578.2	65973.1	19180.7	5854.1	91008.0
NON G-10 DEVELOPED COUNTRIES							
AUSTRALIA	1597.5	5.2	80.7	1511.4	429.3	72.1	2012.9
AUSTRIA	1122.0	17.3	15.5	1089.1	27.7	49.2	1166.1
DENMARK	2182.1	1.0	62.7	2118.4	212.8	56.5	2387.7
FINLAND	1363.7	.0	40.8	1322.9	121.9	30.7	1475.5
GREECE	1918.7	96.1	112.6	1709.9	10.0	127.3	1847.2
ICELAND	129.2	.0	21.4	107.8	.0	.0	107.8
IRELAND, REPUBLIC OF	709.0	14.0	85.2	609.8	117.3	41.9	769.0
NEW ZEALAND	296.1	.0	36.3	259.8	39.5	2.0	301.3
NORWAY	2199.0	6.0	179.3	2013.6	58.9	69.0	2141.6
PORTUGAL	594.4	4.0	37.9	552.5	36.5	5.5	594.5
SOUTH AFRICA	2004.1	22.6	91.4	1890.0	40.5	24.7	1955.3
SPAIN	3478.2	30.0	138.6	3309.5	473.9	10.6	3794.1
TURKEY	1582.6	81.9	51.4	1449.3	2.0	22.2	1473.6
OTHER	227.4	43.0	51.6	132.7	.0	18.6	151.3
TOTALS	19404.5	321.0	1005.9	18077.4	1570.4	530.7	20178.6
EASTERN EUROPE							
BULGARIA	590.6	4.2	.0	586.4	4.5	.0	590.9
CZECHOSLOVAKIA	172.9	.0	.0	172.9	18.0	5.0	195.9
GERMAN DEMOCRATIC REPUBLIC	1151.0	10.0	.0	1141.0	213.0	8.9	1362.9
HUNGARY	827.1	1.0	.0	826.1	10.8	.0	836.9
POLAND	1315.2	83.7	33.9	1197.6	13.8	5.0	1216.4
ROMANIA	323.3	35.9	1.6	285.8	4.3	.0	290.1
U.S.S.R.	1185.8	106.0	11.0	1068.8	193.0	4.0	1265.8
YUGOSLAVIA	1629.8	5.5	167.4	1456.9	27.0	26.5	1510.5
TOTALS	7196.0	246.3	213.9	6735.7	484.4	49.4	7269.6
OIL EXPORTING COUNTRIES							
ALGERIA	1829.9	5.7	232.1	1592.1	8.0	17.9	1618.0
ECUADOR	1560.5	10.2	34.1	1516.1	1.8	2.3	1520.3
GABON	224.6	.0	14.7	209.9	.0	.2	210.1
INDONESIA	2215.4	8.6	309.1	1897.6	55.8	31.1	1984.6
IRAN	2625.6	34.9	44.0	2546.7	206.8	13.0	2766.6
IRAQ	155.4	.0	.0	155.4	1.0	.0	156.4
KUWAIT	779.1	.0	9.5	769.6	27.0	39.9	836.5

TABLE II CROSS-BORDER AND NON-LOCAL CURRENCY CLAIMS ON FOREIGNERS BY COUNTRY OF GURARANTOR: DECEMBER 1978
(IN MILLIONS OF DOLLARS)

COUNTRY	TOTAL CLAIMS (BY RESIDENCE)	CLAIMS GUARANTEED BY RESIDENTS OF OTHER COUNTRIES ON BANKS	CLAIMS GUARANTEED BY RESIDENTS OF OTHER COUNTRIES ON OTHERS	TOTAL CLAIMS LESS GUARANTEED CLAIMS	CLAIMS ON RESIDENTS OF OTHER COUNTRIES GUARANTEED BY RESIDENTS OF THIS COUNTRY ON BANKS	CLAIMS ON RESIDENTS OF OTHER COUNTRIES GUARANTEED BY RESIDENTS OF THIS COUNTRY ON OTHERS	TOTAL CLAIMS BY COUNTRY OF GUARANTOR
OIL EXPORTING COUNTRIES							
LIBYA	138.7	.0	.0	138.7	1.0	15.5	155.2
NIGERIA	618.5	1.3	9.0	608.2	.1	5.0	613.3
QATAR	175.8	6.2	16.9	152.7	12.0	4.0	168.7
SAUDI ARABIA	917.5	92.0	39.1	786.2	6.5	79.0	871.8
UNITED ARAB EMIRATES	1276.9	113.8	48.7	1114.4	57.0	25.2	1196.6
VENEZUELA	7528.9	44.1	261.5	7223.2	14.0	33.4	7270.7
TOTALS	20047.3	317.0	1018.9	18711.3	391.1	266.7	19369.2
NON-OIL EXP DEV COUNTRIES-LATIN AM & CARIBBEAN							
ARGENTINA	2752.5	41.5	133.7	2577.1	66.8	11.9	2655.9
BOLIVIA	590.1	6.1	16.0	567.9	.0	.0	567.9
BRAZIL	13438.1	255.3	1161.4	12021.2	807.1	112.5	12941.0
CHILE	1527.0	19.7	46.9	1460.4	1.3	17.8	1479.5
COLOMBIA	1497.2	56.6	22.5	1418.1	184.5	8.2	1610.8
COSTA RICA	432.8	3.0	40.5	389.3	.0	2.6	392.0
DOMINICAN REPUBLIC	386.2	1.0	1.3	383.9	.0	5.0	388.9
EL SALVADOR	316.7	1.2	12.1	303.4	10.0	1.3	314.7
GUATEMALA	241.4	.0	26.6	214.8	.0	2.9	217.7
HONDURAS	312.5	5.6	15.5	291.3	1.0	3.0	295.3
JAMAICA	229.3	3.0	11.5	214.8	2.0	6.0	222.8
MEXICO	10657.3	146.1	416.0	10095.1	151.5	86.3	10332.9
NICARAGUA	571.7	6.8	12.4	552.5	.0	.5	553.0
PARAGUAY	84.8	10.6	36.6	37.6	.0	.0	37.6
PERU	1664.7	48.1	79.5	1537.1	9.8	.5	1547.4
TRINIDAD AND TOBAGO	87.2	.0	1.1	86.1	.0	.0	86.1
URUGUAY	150.8	.9	3.4	146.4	.0	1.2	147.7
OTHER	590.0	565.4	5.4	19.1	.0	.4	19.6
TOTALS	35531.2	1171.2	2043.1	32316.8	1234.1	260.5	33811.5
NON-OIL EXP DEV COUNTRIES-ASIA							
CHINA, REPUBLIC OF TAIWAN	3315.8	73.4	236.0	3006.4	44.0	161.4	3211.8
INDIA	265.8	.0	11.0	254.8	26.6	8.0	289.4
ISRAEL	1096.5	24.9	18.6	1052.9	300.6	19.8	1373.3
JORDAN	140.0	1.5	23.4	115.1	72.5	.0	187.6
KOREA, SOUTH	3802.3	165.2	145.5	3491.5	260.3	135.7	3887.6
MALAYSIA	537.1	1.0	63.1	472.9	91.1	29.1	593.1
PAKISTAN	106.0	10.4	.0	95.6	37.7	3.0	136.3
PHILIPPINES	2852.6	133.9	133.6	2585.1	30.4	12.5	2628.0
SYRIA	6.9	.0	.0	6.9	.0	1.9	8.8
THAILAND	1235.9	21.2	48.0	1166.6	95.2	13.8	1275.6
OTHER	388.1	18.5	36.0	333.5	20.4	2.0	355.9
TOTALS	13747.3	450.1	715.6	12581.6	978.9	387.3	13948.0
NON-OIL EXP DEV COUNTRIES-AFRICA							
CAMEROON	62.1	.0	5.6	56.5	.0	.0	56.5
EGYPT	565.1	7.1	31.5	526.4	11.0	1.0	538.4
GHANA	65.1	.0	.0	65.1	10.1	.0	75.2
IVORY COAST	418.9	1.0	14.3	403.5	.0	.9	404.5

TABLE II CROSS-BORDER AND NON-LOCAL CURRENCY CLAIMS ON FOREIGNERS BY COUNTRY OF GURARANTOR: DECEMBER 1978
(IN MILLIONS OF DOLLARS)

COUNTRY	TOTAL CLAIMS (BY RESIDENCE)	CLAIMS GUARANTEED BY RESIDENTS OF OTHER COUNTRIES ON BANKS	ON OTHERS	TOTAL CLAIMS LESS GUARANTEED CLAIMS	CLAIMS ON RESIDENTS OF OTHER COUNTRIES GUARANTEED BY RESIDENTS OF THIS COUNTRY ON BANKS	ON OTHERS	TOTAL CLAIMS BY COUNTRY OF GUARANTOR
NON-OIL EXP DEV COUNTRIES-AFRICA							
KENYA	59.0	.0	10.2	48.8	.0	.0	48.8
MALAWI	77.3	.0	.0	77.3	.0	.0	77.3
MOROCO	597.7	.0	3.3	594.4	7.0	.0	601.4
SENEGAL	66.4	1.0	2.0	63.4	.0	.6	64.1
SUDAN	196.1	.4	55.6	140.0	.0	8.7	148.7
TUNISIA	203.7	.0	6.1	197.6	.0	.5	198.1
ZAIRE	242.6	1.3	128.5	112.8	.0	.0	112.8
ZAMBIA	140.7	.0	26.5	114.2	.0	.0	114.2
OTHER	230.0	3.9	43.0	183.1	2.0	.8	185.9
TOTALS	2925.1	14.7	326.7	2583.6	30.1	12.6	2626.4
OFFSHORE BANKING CENTERS							
BAHAMAS	9012.2	7479.5	52.3	1480.3	31.3	26.9	1538.6
BAHRAIN	1208.3	976.3	5.0	227.0	.0	.0	227.0
BERMUDA	556.3	4.2	332.2	219.9	.0	36.7	256.6
BRITISH WEST INDIES	4446.3	3657.2	14.5	774.6	1.0	3.2	778.8
HONG KONG	2396.5	729.5	192.2	1474.6	94.6	360.4	1929.8
LEBANON	119.6	7.3	11.1	101.1	1.6	11.6	114.3
LIBERIA	2217.1	.7	1402.9	813.5	.0	21.7	835.2
MACAO	.9	.0	.0	.9	.0	.0	.9
NETHERLANDS ANTILLES	401.7	67.8	255.4	78.5	5.0	.0	83.5
PANAMA	2885.7	1205.1	553.0	1127.5	40.6	70.2	1238.4
SINGAPORE	2766.9	1952.2	74.4	740.2	33.5	31.3	805.1
TOTALS	26011.8	16080.0	2893.2	7038.6	207.7	562.1	7808.5
INTERNATIONAL & REGIONAL ORGANIZATIONS							
AFRICAN REGIONAL	3.5	.0	.0	3.5	.0	1.5	5.0
ASIAN REGIONAL	2.4	.0	.0	2.4	.0	.0	2.4
E. EUROPEAN REGIONAL	113.1	.0	.0	113.1	.0	.0	113.1
INTERNATIONAL	196.9	13.8	.0	183.1	.0	.6	183.7
LATIN AMERICAN REGIONAL	25.8	.0	.0	25.8	.0	1.1	26.9
MIDDLE EASTERN REGIONAL	.0	.0	.0	.0	.0	2.0	2.0
W. EUROPEAN REGIONAL	91.1	10.0	.0	81.1	7.0	.0	88.1
TOTALS	432.8	23.8	.0	409.0	7.0	5.2	421.2
**** GRAND **** ** TOTALS **	217341.3	41117.9	11795.9	164427.4	24084.7	7929.1	196441.3

TABLE III CROSS BORDER AND NON-LOCAL CURRENCY CONTINGENT CLAIMS: DECEMBER 1978
(IN MILLIONS OF DOLLARS)

	COMMITMENTS TO ADVANCE FUNDS (BY COUNTRY OF RESIDENCE)			COMMITMENTS GUARANTEED RESIDENTS OF OTHER COUNTRIES	COMMITMENTS TO RESIDENTS OF OTHER COUNTRIES GUARANTEED BY RESIDENTS OF THIS COUNTRY	TOTAL COMM. BY COUNTRY OF GUARANTOR
	TOTAL	TO PUBLIC BORROWERS	TO OTHER BORROWERS			
G-10 AND SWITZERLAND						
BELGIUM-LUXEMBOURG	733.1	45.6	687.5	136.4	76.2	672.9
CANADA	1430.6	834.5	596.1	17.8	105.3	1518.1
FRANCE	3357.6	844.4	2513.1	82.2	521.2	3796.6
GERMANY, FEDERAL REPUBLIC OF	2078.0	109.6	1968.4	124.2	228.6	2182.4
ITALY	1055.9	263.6	792.3	113.6	163.6	1106.0
JAPAN	3427.6	75.2	3352.4	209.6	522.7	3740.8
NETHERLANDS	1065.8	128.5	937.3	105.1	54.0	1014.7
SWEDEN	1516.6	159.4	1357.2	40.1	39.6	1516.1
SWITZERLAND	1693.1	174.6	1518.5	135.7	173.4	1730.8
UNITED KINGDOM	5726.8	463.1	5263.6	801.7	725.2	5650.2
TOTALS	22085.6	3098.7	18986.9	1766.7	2610.1	22929.1
NON G-10 DEVELOPED COUNTRIES						
AUSTRALIA	1138.0	179.7	958.3	83.7	54.1	1108.4
AUSTRIA	277.0	64.0	213.0	16.0	54.1	315.1
DENMARK	674.4	267.1	407.2	10.6	16.0	679.7
FINLAND	712.8	338.6	374.2	2.3	5.5	716.0
GREECE	734.1	220.5	513.5	74.3	2.6	662.4
ICELAND	33.8	19.3	14.5	.0	.0	33.8
IRELAND, REPUBLIC OF	231.0	66.4	164.6	58.1	7.1	180.0
NEW ZEALAND	177.3	61.3	115.9	2.3	5.0	180.1
NORWAY	807.1	221.9	585.1	57.2	4.6	754.5
PORTUGAL	417.6	55.1	362.5	8.8	8.0	416.8
SOUTH AFRICA	284.2	44.8	239.4	28.2	4.3	260.3
SPAIN	720.7	174.8	545.8	43.8	6.9	683.8
TURKEY	436.7	197.7	239.0	34.2	.0	402.5
OTHER	219.4	36.6	182.8	20.6	.8	199.6
TOTALS	6864.5	1948.1	4916.3	440.3	169.2	6593.3
EASTERN EUROPE						
BULGARIA	79.2	27.4	51.8	.6	.0	78.6
CZECHOSLOVAKIA	67.0	8.0	59.0	.0	.0	67.0
GERMAN DEMOCRATIC REPUBLIC	118.9	35.5	83.4	.0	2.2	121.1
HUNGARY	81.6	72.1	9.5	25.0	5.0	61.6
POLAND	963.9	568.0	395.8	526.6	.6	437.8
ROMANIA	206.2	103.2	103.0	11.6	.0	194.6
U.S.S.R.	316.1	46.4	269.7	32.2	1.7	285.6
YUGOSLAVIA	586.3	43.0	543.2	60.4	1.5	527.4
TOTALS	2419.4	903.8	1515.6	656.5	11.1	1774.0
OIL EXPORTING COUNTRIES						
ALGERIA	552.5	296.5	255.9	44.2	4.2	512.5
ECUADOR	496.6	258.1	238.5	9.4	.1	487.3
GABON	16.2	11.6	4.6	6.9	.0	9.3
INDONESIA	659.1	333.9	325.2	74.1	18.2	603.2
IRAN	789.6	222.0	567.5	79.1	3.2	713.7
IRAQ	243.2	105.0	138.2	.3	.0	242.9
KUWAIT	302.4	23.0	279.4	5.0	13.2	310.6
LIBYA	276.7	59.8	216.9	.7	3.0	279.0

TABLE III CROSS BORDER AND NON-LOCAL CURRENCY CONTINGENT CLAIMS: DECEMBER 1978
(IN MILLIONS OF DOLLARS)

	COMMITMENTS TO ADVANCE FUNDS (BY COUNTRY OF RESIDENCE)			COMMITMENTS GUARANTEED RESIDENTS OF OTHER COUNTRIES	COMMITMENTS TO RESIDENTS OF OTHER COUNTRIES GUARANTEED BY RESIDENTS OF THIS COUNTRY	TOTAL COMM. BY COUNTRY OF GUARANTOR
	TOTAL	TO PUBLIC BORROWERS	TO OTHER BORROWERS			
OIL EXPORTING COUNTRIES						
NIGERIA	333.9	171.2	162.7	28.9	.3	305.3
QATAR	151.8	74.4	77.4	22.2	6.0	135.6
SAUDI ARABIA	805.5	71.8	733.7	70.4	32.8	767.9
UNITED ARAB EMIRATES	264.3	59.2	205.0	17.3	30.7	277.6
VENEZUELA	2605.4	1072.2	1533.1	31.4	32.6	2606.6
TOTALS	7497.5	2759.0	4738.4	390.1	144.5	7251.9
NON-OIL EXP DEV COUNTRIES-LATIN AM & CARIBBEAN						
ARGENTINA	957.5	335.5	622.0	89.6	5.4	873.2
BOLIVIA	191.9	75.1	116.7	19.3	.0	172.6
BRAZIL	2261.9	700.4	1561.4	256.7	109.4	2114.5
CHILE	697.7	342.1	355.6	29.7	4.0	672.1
COLOMBIA	837.7	398.2	439.5	1.5	1.1	837.3
COSTA RICA	247.9	95.3	152.6	22.2	2.0	227.6
DOMINICAN REPUBLIC	99.6	31.7	67.9	2.4	.0	97.2
EL SALVADOR	107.4	38.6	68.8	4.8	10.7	113.3
GUATEMALA	195.5	131.4	64.1	29.0	5.4	171.8
HONDURAS	138.9	50.5	88.4	17.4	.0	121.4
JAMAICA	73.5	54.4	19.1	3.6	.0	69.9
MEXICO	1978.6	443.0	1535.5	69.7	47.2	1956.0
NICARAGUA	97.2	30.5	66.6	.9	.4	96.7
PARAGUAY	46.2	14.1	32.0	1.9	.3	44.6
PERU	217.6	98.7	118.8	45.1	5.2	177.7
TRINIDAD AND TOBAGO	148.8	133.2	15.6	11.0	.1	137.9
URUGUAY	161.5	121.5	39.9	1.5	55.0	215.0
OTHER	54.6	17.3	37.3	15.2	.0	39.4
TOTALS	8514.7	3112.1	5402.5	622.3	246.3	8138.7
NON-OIL EXP DEV COUNTRIES-ASIA						
CHINA, REPUBLIC OF TAIWAN	1651.1	907.5	743.5	58.4	25.0	1617.6
INDIA	260.4	68.1	192.3	6.2	11.1	265.3
ISRAEL	252.1	66.4	185.7	6.2	1.9	247.8
JORDAN	131.6	83.1	48.5	.5	20.9	152.0
KOREA, SOUTH	1819.1	240.1	1579.0	78.4	39.5	1780.3
MALAYSIA	216.0	91.2	124.8	21.6	5.0	199.3
PAKISTAN	206.3	78.0	128.3	31.0	5.5	180.8
PHILIPPINES	1648.4	833.2	815.2	92.0	7.9	1564.3
SYRIA	110.6	34.6	76.0	.2	.0	110.4
THAILAND	502.3	146.4	355.8	27.0	11.4	486.7
OTHER	325.1	132.3	192.8	13.9	11.6	322.8
TOTALS	7123.6	2681.2	4442.3	335.7	139.9	6927.8
NON-OIL EXP DEV COUNTRIES-AFRICA						
CAMEROON	22.9	8.7	14.2	5.1	.0	17.8
EGYPT	699.6	257.1	442.4	204.6	19.2	514.1
GHANA	108.3	84.8	23.5	1.0	6.9	114.2
IVORY COAST	75.8	46.8	28.9	10.4	1.3	66.6
KENYA	40.0	1.5	38.5	.0	.0	40.0
MALAWI	29.0	5.0	24.0	.0	16.0	45.0

TABLE III CROSS BORDER AND NON-LOCAL CURRENCY CONTINGENT CLAIMS: DECEMBER 1978
(IN MILLIONS OF DOLLARS)

	COMMITMENTS TO ADVANCE FUNDS (BY COUNTRY OF RESIDENCE)			COMMITMENTS GUARANTEED RESIDENTS OF OTHER COUNTRIES	COMMITMENTS TO RESIDENTS OF OTHER COUNTRIES GUARANTEED BY RESIDENTS OF THIS COUNTRY	TOTAL COMM. BY COUNTRY OF GUARANTOR
	TOTAL	TO PUBLIC BORROWERS	TO OTHER BORROWERS			
NON-OIL EXP DEV COUNTRIES-AFRICA						
MOROCO	271.0	147.1	123.9	41.0	.0	230.0
SENEGAL	21.9	18.9	3.0	.3	.0	21.6
SUDAN	36.9	19.0	17.9	2.1	.0	34.8
TUNISIA	149.9	94.6	55.3	13.2	.0	136.7
ZAIRE	27.6	19.9	7.7	4.3	.0	23.3
ZAMBIA	130.3	69.6	60.7	8.9	.0	121.4
OTHER	329.1	145.2	183.9	23.6	10.3	315.8
TOTALS	1942.5	918.4	1024.1	314.6	53.7	1681.6
OFFSHORE BANKING CENTERS						
BAHAMAS	155.4	10.0	145.4	112.7	3.2	45.9
BAHRAIN	237.5	89.0	148.5	133.0	8.8	113.3
BERMUDA	466.9	60.9	406.0	230.9	5.0	241.0
BRITISH WEST INDIES	80.3	.0	80.3	73.1	2.3	9.5
HONG KONG	981.5	141.0	840.5	283.8	12.0	709.7
LEBANON	188.8	18.0	170.8	11.2	7.9	185.5
LIBERIA	220.6	38.2	182.4	87.8	12.4	145.2
MACAO	1.0	.0	1.0	.0	.0	1.0
NETHERLANDS ANTILLES	299.6	11.3	288.3	88.1	.0	211.5
PANAMA	450.4	139.9	310.5	73.1	12.5	389.8
SINGAPORE	488.1	88.4	399.7	89.9	15.1	413.2
TOTALS	3570.4	596.7	2973.6	1183.7	79.2	2465.9
INTERNATIONAL & REGIONAL ORGANIZATIONS						
AFRICAN REGIONAL	23.0	23.0	.0	.0	.0	23.0
ASIAN REGIONAL	.0	.0	.0	.0	.0	.0
E. EUROPEAN REGIONAL	.0	.0	.0	.0	.0	.0
INTERNATIONAL	17.2	17.2	.0	.0	20.7	37.9
LATIN AMERICAN REGIONAL	3.1	1.3	1.8	.0	91.4	94.5
MIDDLE EASTERN REGIONAL	3.0	.0	3.0	.0	.0	3.0
W. EUROPEAN REGIONAL	5.0	5.0	.0	.0	.0	5.0
TOTALS	51.3	46.5	4.8	.0	112.1	163.5
**** GRAND **** ** TOTALS **	60070.0	16065.1	44004.9	5710.2	3566.4	57926.1

QUESTION: Explain the problems and the solutions to those problems, highlighted in the September 29, 1978, memo to Cathryn Goddard from Dirck Keyser, Re: Oil Exporter Placements (SRA-46). The memo notes that unrecorded inflows of foreign buying in the stock market (presumably by OPEC nations) amounted to $3.8 billion first quarter of 1978 and accelerated to $8.0 billion in the second quarter. It concludes that Treasury may not be getting all securities transactions on the S forms. The author of the memo further states that he and Dave Curry seem:

> "to share my view that there could also be unrecorded portfolio shifts within the United States; his speculation in this realm extends not only to the possible unrecorded stock purchases which I have suggested, but also to commodities and real estate. He suspects there may also have been some shift into other currencies, and I agree that this seems probable, too."

We are concerned by these gaps in data coverage. Given the large magnitude which appears to be unreported, what actions have you taken to cover this apparent gap in foreign portfolio coverage? If none have been taken, what are you considering?

ANSWER: Mr. Keyser's Memorandum entitled "Oil Exporter Placements" addressed to Cathryn Goddard on September 29, 1978, offered interpretive comments on the apparent decline in oil exporters' bank deposits and Treasury securities held in the U.S. Your letter states that Mr. Keyser referred to $3.8 billion of unrecorded stock buying in the stock market (presumably by OPEC nations) in the first quarter of 1978 and $8.0 billion in the second quarter. Mr. Keyser's memo did not refer to stock market purchases - by OPEC or anyone else. This is an incorrect reading of Mr. Keyser's memo. Mr. Keyser's reference was in fact to the errors and omissions item - the balancing item in the statistics on the U.S. balance of payments. Obviously we do not know the composition of this item since it represents the net of all the transactions with the rest of the world which we miss. It is very erratic and shifts from positive to negative and from a small figure to a large one as shown in the following table:

Errors and Omissions in the U.S. Balance of Payments

($ millions)

1972		- 1,966
1973		- 2,725
1974		- 1,684
1975		5,449
1976		9,300
1977		- 927
1978	I Q	3,638
	II Q	8,979
	III Q	893
	IV Q	- 2,061

The dominant elements in this unrecorded item are believed by many analysts to be shifts in the time differential between shipments of goods and the payment for the goods together with other very short term capital movements.

In his memorandum, Mr. Keyser was speculating as to whether the conventional wisdom could be wrong, at least in part, and whether some portion of the inflows during the period being discussed -- not all $12 billion -- could have been longer-term capital flowing into the stock markets. The memorandum was considering the extent to which some of the draw-down of bank deposits and Treasuries could have been for the purpose of buying U.S. stock and corporate bonds, rather than to move into other currencies, which was an alternate possibility. It now appears that the draw-downs were, except in June, confined to short-term Treasuries and bank deposits. Reported flows show net OPEC purchases of long-term U.S. securities of $519 million during the first half of 1978.

The Department of Commerce has responsibility for the overall balance of payments statistics. Treasury collects the information on capital movements other than direct investment. The Treasury Department would obviously like to see a reduction in the estimating errors and an increase in the comprehensiveness of the statistical coverage. We work toward that end constantly. I am confident that Commerce does so as well.

But the fact that the net of the unexplained movements is larger than we would like is not a matter of grave national concern. It is not so serious as to justify an increase in the manpower and resources devoted to it.

One of the functions of Mr. Keyser's office in the Treasury is to review the adequacy of our reporting forms. It is almost certain that any portfolio investment inflows not captured on the Treasury International Capital (TIC) S Form are very small. The error in estimating foreign holdings of U.S. securities from these reports averaged about 1% per annum over the 33 years between the 1941 and the 1974 benchmark surveys of foreign portfolio investments in the United States. The Department is now compiling and analyzing the results of the 1978 survey. One of the specific purposes of this analysis is to uncover shortcomings in the existing reporting system.

Despite this, we continue to review carefully the adequacy of our reporting systems. The present S form was revised after the 1974 survey to provide more detail on foreign holdings of U.S. securities, and is of course constantly under review for possible improvement. A number of respondents to the 1974 survey indicated prospective reporting responsibilities on Form S. Letters were sent to these putative reporters requesting that they review Form S reporting requirements and advise the Treasury accordingly. All firms did respond and some new reporters were added to our Panel.

QUESTION: A document entitled "OPEC Current Account Trends," issued by OASIA:IDN:DWolkow, May 21, 1979, estimates the following:

"Total OPEC net investment income should exceed $7 billion annually in 1979 and 1980, almost entirely concentrated in Saudi Arabia ($4.3 billion), Kuwait ($2.2 billion), the UAE ($1.1 billion) and Iraq ($1.0 billion)."

In the appendix to your statement of testimony, we would like you to answer the following questions about OPEC investment income. First, of the above amounts, how much

is income generated from investments in the United States or in U.S. financial instruments? Second, how much of this income will remain in the United States or be reinvested in U.S. financial instruments and how much will be removed from the United States (for repatriation or other country investment)? Second, what have been the past practices of these nations in this regard; have they repatriated the income, have they used it for investments in non-U.S. assets, or have they reinvested? What is the approximate percentage in each category for each of the above countries fo. the years 1974 through 1978?

ANSWER: Data on income remittances from the United States to foreign residents are compiled by the Commerce Department Such data for individual Mid East oil exporting countries are not disclosable because they would divulge the size of the holdings of an individual foreign investor.

With regard to the disposition of income from OPEC investments in the U.S., the practice varies both from country to country and investment to investment. Income from some U.S. investments of OPEC countries is transferred to accounts outside the U.S.; other income is retained here in the first instance.

The economic significance of an OPEC country's policy with respect to the handling of its investment income is far less than either the total stock or total flows of investment capital. Income transferred abroad may be reinvested in the U.S. within a very short period of time and vice versa. OPEC countries -- and most other investors -- determine the desired composition of their investments on the basis of the total outstanding stock of their assets, whether such stock represents original principal or reinvested earnings.

QUESTION: Have any promises or agreements, whether implicit or explicit, and/or arrangements or assurances been made or given between any or several OPEC nations and the United States conferring protection against U.S. Government action toward OPEC assets?

ANSWER: No special protection of OPEC investments in the U.S. has ever been offered or implied so far as I am aware.

QUESTION: If there were an attempt by one or more of the wealthier OPEC countries to withdraw a large amount of assets from the United States, either by sales of U.S. Government securities, removal of deposits from American

banks (both foreign and domestic branches), or large sales of corporate bonds or stocks, or a combination of all three, (1) briefly, what specific actions can the President take to intervene to either stop the withdrawal or alleviate its effects, (please answer this question for each group of assets referred to above); and (2) have contingency plans been established? How do these interact with any promises assurances,etc. referred to above under Section IV? Why are Secretary Blumenthal and other Treasury officials so concerned about withdrawal if effective remedies exist to prevent withdrawal? Can these remedies be readily invoked?

ANSWER: Under the International Emergency Economic Powers Act ("IEEPA"), P.L. 95-223, title II, 50 U.S.C. Secs. 1701-06, enacted in 1977, anticipated withdrawals of foreign assets of such a magnitude as to threaten the economy and security of the United States would justify the President's use of the emergency powers provided in IEEPA. These powers include the power to block transfers of property in which there is a foreign interest. Accordingly, in extraordinary emergency circumstances the President has the power to stop any withdrawals of foreign assets from the U.S. The remedies available under IEEPA can be quickly invoked.

No special plans have been made for the contingency of a large withdrawal of funds by an OPEC country and none is considered necessary.

As noted in my statement, a sudden withdrawal of a very large volume of funds from the U.S. or the offering of a very large sum of dollars on the foreign exchange markets - whether by OPEC or any other investors - would have adverse effects on our markets. We would obviously like to avoid them.

As noted in the response to an earlier question no special treatment of OPEC investments in the U.S. has been offered.

QUESTION: The memo to you from Mr. Widman, supra, contains the following statement: "Neither State staff, nor CIA staff, fully appreciated the sensitivity or implications of releasing these (Saudi investment) data." Advise us of the nature of discussions with CIA and State Department staff regarding this issue, the names of the persons or the CIA and State staffs involved, and the approximate dates of such discussions. Which other agencies have disagreed with Treasury on this issue?

ANSWER: In June 1978, Treasury staff had discussions with a staff officer of the State Department and a staff officer of the CIA regarding a proposed response to a letter to Secretary Vance from Congressman Scheuer dated May 25, 1978. Prior to these discussions, the CIA, in response to a State Department request, had furnished State classified information some of which was obtained from its own sources and other of which had been collected under the authority of the International Investment Survey Act of 1976. Treasury pointed out that some of such information could not be disclosed while other information could be disclosed only on a classified basis. Treasury, State and CIA then agreed that the response to Congressman Scheuer should reflect this position regarding handling the information; there was no disagreement. Neither have there been disagreements with any other agencies on this issue.

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WASHINGTON, D.C. 20220 TELEPHONE 566-2041
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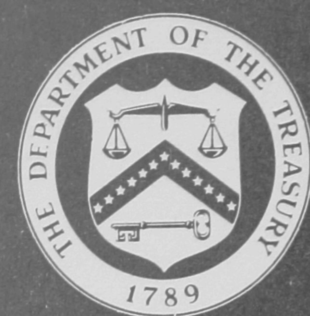

FOR RELEASE UPON DELIVERY
EXPECTED AT 1:00 P.M.
WEDNESDAY, JULY 18, 1979

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

Mr. Chairman and members of this distinguished Committee:

As this Committee meets to consider the changing economic outlook and its implications for the Budget, it is clear that the problems of inflation and energy dominate the economic scene. They are interrelated. Rising costs of energy are now the principal force driving our inflation. Failure to cope with the energy problem would leave us subject to further increases in oil prices imposed by forces beyond our control. Coping with the energy problem will require us to devote substantial resources to the development of alternatives to imported oil.

Thus, our alternatives are limited--but clear. The President has mapped out the course we must follow: binding resolve to limit our dependence on imported oil, massive efforts to develop our domestic sources of energy, and strict conservation of energy until the domestic sources can come on stream in adequate quantity. We cannot solve the energy problem or the inflation problem unless we are willing to make the sacrifices--individually, collectively and equitably--that are necessary to insure our economic future.

Inflation. Our core problem is inflation--inflation that is decimating the purchasing power of American consumers, inhibiting business investment, weakening our export competitiveness.

Since last December, consumer prices have risen at a 13-1/2 percent annual rate, a sharp acceleration from the 9 percent of last year, and almost double the inflation rate in 1977.

Earlier in the year, a major element in the inflation was the rise in food prices, as adverse weather conditions

B-1727

and strikes pushed the food component of the Consumer Price Index to a 20 percent annual rate of increase. But increasingly, the thrust to inflation has come from rising energy prices. The food supply situation has improved, and the rate of increase in food prices at retail has slowed--although retail prices have not yet reflected the actual declines in food prices at the wholesale level.

But while the rise in food prices has decelerated, the increase in energy prices has accelerated, as the increases in crude oil prices levied by the OPEC nations last December and additional surcharges added by most oil producing nations began to permeate the price structure. In January and February, some 30 percent of the increase in consumer prices resulted from the rise in food prices, and only 10 percent was attributable to increased energy costs. By May, the proportions were reversed, with just over one-tenth of the May rise in consumer prices the result of higher food prices, and about one-third of the total reflecting increases in energy prices. Since the beginning of the year, energy product prices at retail have gone up at almost a 38 percent annual rate, more than three times faster than the rest of the items bought by consumers.

Moreover, these figures measure only the direct increase in energy product prices--the rise in gas, electricity, gasoline and heating oil prices. But rising energy costs affect prices of all other goods. Very sharp increases have been registered in the past few months across a variety of petroleum-based chemicals, and these will show up in finished goods prices later on, as will the higher costs of transportation engendered by rising energy prices.

It is important to recognize the extent to which the inflation that has plagued us this year has stemmed from forces not directly related to current levels of domestic demands but rather has reflected forces which were unpredictable and over which we have had no control. The persistence of double-digit inflation despite the gradual and now clear slowing in economic activity has been interpreted by some as a measure of the failure of the Administration's efforts to move toward price stability through a voluntary program dependent essentially on the cooperation of business and labor. From this assessment of failure, some have argued for abandonment of the program, others have argued that the voluntary program should be supplanted by mandatory controls.

But such glib and premature conclusions do not stand up to a more careful analysis of the price statistics. Approximately half the composition of the Consumer Price Index is accounted for by three categories: food, energy, homeownership costs. For one or another reason, these areas are not within the effective scope of the wage/price deceleration program--nor, for that matter, would they be any more amenable to control under a mandatory system. But the major price acceleration this year has been in just these areas. Prices of food, energy and home-ownership combined have increased this year at a 20 percent annual rate, up from 11 percent last year. The rest of the CPI has accelerated too--not decelerated, as we had hoped--but the acceleration has been quite modest, from 6.7 percent last year to a 7.0 percent rate in the first five months of 1979.

On the wage side of the program, the publicity attendant on several major collective bargaining settlements that were judged to be outside the guidelines in varying degree has led to similarly premature conclusions about the failure of the deceleration program. But the most reliable measure of changes in wages--the BLS series on average hourly earnings for production workers--has increased thus far this year at an annual rate of under 8 percent, compared with an 8.5 percent increase during 1978. Wage increases have not been a primary cause of accelerating inflation.

Nevertheless, unit labor costs have accelerated sharply. This apparent anomaly reflects in part the acceleration in private and publicly-mandated fringe benefits, but even more importantly, it has reflected the continued disappointing and puzzling behavior of productivity. The slowing in productivity gains over the past decade has been one of the grave weaknesses in our economic life, for it is putting severe constraints on our ability to raise our living standards while reducing our ability to compete in international markets. Last year, productivity in the private business sector increased by less than half of one percent--compared with an annual average increase of 3.1 percent in the first two postwar decades--and in the first quarter of this year, productivity actually declined substantially. As a result of the collapse in productivity, and the rise in compensation costs resulting from social security tax increases and the higher mimimum wage, unit labor costs have soared this year, while wages have decelerated.

The moderation in wages while inflation has remained so high has resulted in a substantial reduction in consumer

purchasing power. During the first five months of this year, real hourly wages fell at an annual rate of almost 5-1/2 percent, and would have fallen more without the January increase in the minimum wage. And given the small increase in nominal earnings in June, real wages probably declined further during the month.

The squeeze on real incomes explains, in large measure, the sluggishness of retail sales this year. In real terms, retail sales have declined 6 percent over the first six months of the year.

To be sure, some pause in consumer buying was to be expected this year after the unusually rapid pace of consumer spending in the final months of 1978. Historically, a buying binge such as occurred in the fourth quarter of last year is followed by a period of consumer moderation. The moderation has continued too long, however, to be merely a reaction to earlier free-spending. The consumer is increasingly constrained by declining real incomes, heavy debt repayment burdens, lack of adequate availability of the products he is willing to buy--small, fuel-efficient cars--and, more recently, by the necessity to husband gasoline. It is difficult to maintain normal shopping habits if one spends an abnormal amount of time queuing up for gasoline, and spends an abnormal proportion of income once one reaches the pump. Reduced traffic at shopping malls testifies to the OPEC impact on our domestic economic developments.

The weakness in consumer spending in recent months is being reflected down the production chain to industrial output and employment. Employment gains in recent months have been much smaller than earlier in the year, and employment in manufacturing has declined--modestly--in each of the past three months. It is worth noting, however, that unemployment has declined in all but one month this year, and the latest unemployment rate reported by the BLS, 5.6 percent, is the lowest in almost 5 years. Nevertheless, continued sluggishness in retail sales will undoubtedly result in some downward adjustment of business production and employment schedules in the months ahead.

One factor that has sustained the economic expansion so long has been the prompt adjustment businesses have made in output to avoid excessive inventory buildup. There was an acceleration in business accumulation of inventories earlier this year, partly to replace stocks depleted by the surge in consumer spending late in 1978, partly in anticipation of strike-interruptions, partly in anticipation of further inflation. But the latest figures indicate some

slowing in the rate of inventory additions at the manufacturing level, and purchasing agent reports suggest increased caution in business buying plans for materials. Inventory/sales ratios are low by historical standards, except for certain specific areas such as the larger-size autos.

One of the elements of strength in the economic picture, therefore, is that we are not weighed down with large, excess inventories that would have to be liquidated abruptly if consumer spending deteriorated further. Moreover, business capital spending plans, and appropriations to implement these plans, remain relatively strong. New orders for capital goods, other than defense items, returned to a respectable rate of increase in May, after a puzzling sharp decline in April.

Finally, U.S. exports have been sustained at a relatively high level, some 16 percent higher in the first five months of the year than the monthly average in 1978. Foreign demand for our agricultural products remains strong, and continued sizeable increases in nonagricultural exports are likely.

Thus, the economy does not demonstrate the characteristics that in the past have preceded a sharp or prolonged downturn. Sluggishness--teetering on the edge of a mild recession--is probably a better characterization of the current state of the economy, a sluggishness induced by the inflation-erosion of consumer purchasing power, and by consumer and business uncertainties about the cost and availability of energy supplies.

We expect this sluggishness to continue for several months, at least until abatement in the rate of inflation permits an end to the decline in real incomes. When consumer purchasing power begins to improve, spending will, too. Since businesses have kept the rate of inventory accumulation closely tied to the rate of sales, a resumption of consumer purchases should be accompanied by some inventory rebuilding. It is reasonable, therefore, to expect the decline in economic activity this year to be mild and, in terms of postwar cyclical experience, of relatively short duration.

Economic activity should be on the rise later this year or early in 1980. But the recovery next year should also be moderate, in part because still unacceptably high rates of inflation will require continued fiscal austerity.

Energy. The OPEC oil price actions since December have been a major factor depressing economic progress and intensifying inflationary pressures in the United States, and the impact of these price increases on growth and inflation will continue to be felt in the months ahead. We estimate that growth in real GNP will be lower by about 1 percent this year and by another 1 percent in 1980, and inflation about 1 percent higher in each year, than would have been the case if OPEC had adhered to the oil price schedule announced last December. As a consequence of the price actions taken since December, there will be 800 thousand more persons unemployed by the end of 1980 than forecast earlier, raising the unemployment rate by approximately 0.8 percent.

Ours is not the only economy, of course, that is having to make difficult adjustments to escalating oil prices and diminished oil availability. It is estimated that the direct, first round effect of the 60 percent rise in world oil prices since last December will be to cut one percent from the average growth rate of OECD countries in 1979, and 1-3/4 percent in 1980. It will add 1-1-1/2 percent to the average OECD inflation rate in 1979, and 2-2-1/2 percent in 1980.

Despite the higher oil import bill, we expect further substantial reductions in the U.S. current account deficit--perhaps even a small surplus next year--because of the reduction in non-oil imports associated with slower growth in our domestic economy, because of continued strong export performance, and because of increased earnings on our overseas investments.

More generally, however, the oil price increase will reverse much of the progress that had been made in improving the world balance of payments. As the OPEC surplus, which had nearly disappeared last year, again surges to levels reminiscent of 1974-75, the OECD countries as a group will move from surplus into deficit. And the position of the non-oil developing countries, already in large deficit as a group, will deteriorate sharply, increasing the problems of some of the poorest nations.

These problems were recognized and addressed directly at the recent Summit meeting in Tokyo. The world leaders assembled there concluded:

- First, there is no alternative to conservation in the short-run. If we do not deliberately

reduce our consumption of oil in ways that are least damaging to our economy, conservation will be forced by whatever increase in price it takes to reduce demand to the level of supply.

- The Summit nations each committed themselves to limits on oil imports in 1979 and 1980, limits that will apply on a country by country basis. The limit for the United States is 8.5 million barrels a day in both years--equivalent to our imports in 1977.

  For the medium-term, the Summit countries adopted specific goals for a ceiling on oil imports in 1985, goals which--assuming reasonable rates of economic growth over the period--will require very powerful efforts to limit oil consumption and develop alternative sources of energy.

- Finally, the Summit participants launched major initiatives to make use of alternative energy sources, particularly coal.

Implementing our Summit commitments will, in the longer-run, require difficult decisions and hard choices. The investment costs of developing alternative energy supplies will impinge on the availability of resources for other purposes. Personal as well as governmental budgets will feel the impact.

But in the end, there really is no choice. If we remain so dependent on imported energy, we will ultimately pay an even greater price, both in monetary terms and in terms of world leadership. Some months ago I reported to the President the results of a year-long study conducted by the Treasury of the threats to our economic welfare and national security posed by our heavy dependence on imported oil. We concluded that this threat was real and imminent. Recent events have underscored that finding.

Conclusion. As we survey the economic outlook here and abroad, and try to match the range of policy tools available for restoring adequate rates of growth and reducing inflation with the varied and serious problems we face, some guiding principles emerge:

- It would make no sense at this stage to rush in with a program to pump up the economy by either a new tax cut or spending programs, or by an easing of monetary restraint.

  -- There is not a sufficient body of consistent evidence to justify "pushing the panic button" on macro economic policies. There could be no credibility--at home or abroad--in our dedication to conquer inflation if we were to switch policies with each swing in the statistics.

  -- Traditional countercyclical economic policies simply do not address the root causes of our current slowdown or of the current double-digit inflation. In fact, an expansionary policy now would aggravate inflationary pressures, and divert resources needed to solve our productivity and energy supply problems.

- We must aggressively pursue policies to encourage conservation of oil and to increase the availability of domestic energy sources and to make more rational use of them, thereby lessening our dependence on foreign energy sources, for which the costs and availability are outside our control.

- We must reduce the gap between wages and unit labor costs. That means pursuing policies to restore productivity, particularly by encouraging more rapid growth in and rejuvenation of our capital stock. It also means holding down the rise in the costs of fringe benefits, such as health care.

- We must avoid being trapped into a wages-chasing-prices cycle such as characterized the 1975-77 period, when we suffered from a relatively high underlying rate of inflation despite significant underutilization of labor and industrial capacity. The costs of compensating labor for past losses of real income must not be imposed on the future price structure. This would be a futile process, for it would merely perpetuate the inflation that already threatens the maintenance of our living standards. The principle of voluntary compliance with a program for deceleration in prices and wages must be preserved.

. We must protect the value of the dollar in international markets, for depreciation of the dollar feeds back into higher inflation domestically.

The fiscal policies recommended by the President last January, and reaffirmed in this mid-session Budget review, conform to these principles. We are not wavering in our dedication to the fight on inflation.

Neither are we heedless of the slowing in the pace of economic activity. If, at some point in the future, countercyclical policies prove to be necessary, the choice of measures will have to be considered most carefully. There are significant constraints on our flexibility in coping with cyclical disturbances.

-- We will have to avoid policies that might jeopardize the strength of the dollar in foreign exchange markets.

-- We will have to avoid policies that would increase the share of output absorbed by government at the expense of the private sectors.

-- We will have to emphasize those fiscal policies that contribute to our fight on inflation by reducing costs and encouraging greater productivity growth.

These are relevant and serious considerations in appraising the appropriateness of policy alternatives. But they are not problems requiring resolution at the moment.

With both inflation and recession prospects so much a function of energy supplies and prices, our immediate priority must be the implementation of a program that puts us far along the road to mastery of energy problems. The program announced by the President will accomplish this with a minimal net effect on our budgetary situation over the next decade, for the initiatives will be financed from the proceeds of the windfall profits tax. Economically, the program will require us to devote a significant share of our resources to development of alternative energy sources. With an economy as large, resilient and flexible as ours, I have no doubt that the goals of the program can be achieved. What we need is the dedication to succeed.

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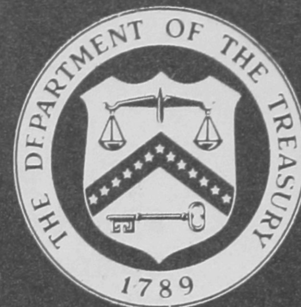

FOR RELEASE AT 4:00 P.M. July 17, 1979

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 July 26, 1979. This offering will not provide new cash for the Treasury as the maturing bills are outstanding in the amount of $6,020 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 April 26, 1979, and to mature October 25, 1979 (CUSIP No. 912793 2S 4), originally issued in the amount of $3,009 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated July 26, 1979, and to mature January 24, 1980 (CUSIP No. 912793 3N 4).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing July 26, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,564 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, July 23, 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. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. 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. 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, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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 on July 26, 1979, in cash or other immediately available funds or in Treasury bills maturing July 26, 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.

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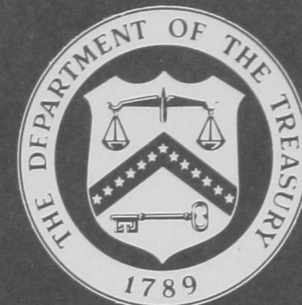
HINGTON, D.C. 20220 TELEPHONE 566-2041



For Release Upon Delivery
Expected at 9:15 A.M.
Wednesday, July 18, 1979

STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE
BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

Mr. Chairman and Members of the Committee:

I appear today to discuss tax-exempt financing of single family housing mortgages.

My testimony today is divided into two parts. First is the effect on the Federal budget and other economic effects of such mortgage financing, and second, the potential impact on the municipal bond market itself, if this type of financing is not eliminated.

BACKGROUND

Almost one year ago, the City of Chicago sold an unprecedented $100 million issue of tax-exempt revenue bonds solely for the purpose of making mortgage loans on single family homes. The rate on such loans was 7.99 percent, approximately two full percentage points less than conventional mortgage rates. Such a differential in interest cost means an after tax savings of approximately $40 per month for the first few years of a 30-year - $35,000 mortgage. Families with incomes up to $40,000 qualified for such loans. Most importantly, the City of Chicago had no liability on the bonds.

Since that time, local governments in 13 states have issued over $2 billion of single family mortgage backed securities with only limited personal income standards for eligibility. State housing agencies, which traditionally have financed multi-family housing, have also issued single family mortgage subsidy bonds.

During the first four months of 1979, over one quarter of all tax-exempt financing was for single family housing. If this type of financing were to continue to expand, projections indicate that the impacts on the tax-exempt market and the Federal budget could be severe.

As you know, the Ways and Means Committee is considering a bill, H.R. 3712, which, as introduced, would revise the tax code to completely eliminate tax-exempt financing of single family mortgage subsidy bonds. The bill would, however, allow state and local governments to continue to finance low and moderate income multi-family housing. The Administration supports this bill, and let me explain our reasons for doing so.

FEDERAL BUDGET AND OTHER ECONOMIC EFFECTS

If Congress fails to take positive action on H.R. 3712, the continued growth of single-family-mortgage subsidy bonds will have substantial Federal budget and other economic effects.

Revenue Loss

Let me first discuss the potential revenue loss. The Treasury estimates that if this financing is not restrained, the potential cost to the taxpayer will range from $4.4 billion to $22.1 billion by 1984. This range reflects varying assumptions on the share of residential mortgages financed in the tax-exempt market. The lower estimate represents a shift to tax-exempt financing of only 10 percent from the conventional mortgage market through 1984. The $22.1 billion represents the cost of financing 50 percent of all residential mortgages in the tax-exempt market.

My assessment is that the larger estimates are more probable, since at the local level, public officials have been very attracted to this type of financing. It enables them to deliver lower cost housing finance, at no explicit cost to their local budget.

Federal Control

In recent years there has been a growing concern with the growth of the Federal budget and Federal credit and steps have been taken to improve control over it. For example, the Congressional Budget Act of 1974 mandated an annual review of tax expenditures -- the use of the tax system to channel funds towards activities without budgeting for them or seeking appropriations from the Congress. In addition, the Administration's FY 1980 Budget announced the establishment of a Federal credit control program, intended to limit and order the Federal presence in credit market activities with annual Federal direct loan and loan guarantee limitations contained in appropriation Acts.

The Administration and Congress obviously are trying to exert greater control over the Federal Budget and Federal credit assistance. The emergence of tax-exempt mortgage subsidy bonds, and the related, large potential for revenue losses, poses major difficulties of control and is untimely. The lack of Federal control over the potentially large revenue losses, and the growth of this new component of the capital markets makes future budget and credit planning difficult. It also has the highly undesirable effect of increasing the growth of uncontrollable off-budget costs.

Inflation Effects

Further growth of tax-exempt mortgage subsidy financing also can be inflationary. First, over the short term, the Federal revenue losses will mean larger budget deficits than otherwise would occur, with proportionately negative implications for inflation. Second, mortgages financed by tax-exempt bonds represent much cheaper financing for housing. As a result, they may over stimulate housing demand. The effects of fiscal and monetary policy on the economy and inflation are thus weakened.

Inefficient Subsidy

Further, tax-exemption as a subsidy is very inefficient -- not all the subsidy goes to the recipient. Treasury estimates that mortgage subsidy bonds deliver only 33 cents in subsidy for each dollar of cost because of the large amount of funds going to underwriting costs and various reserves and because of the large impact on municipal borrowing costs generally. Also, the Federal Government is already

subsidizing housing in a number of important ways. Among tax subsidies to homeowners alone, which will involve an estimated $17 billion in revenue losses in FY 1980, are:

-- deduction of interest--$9.3 billion

-- deduction for real estate property taxes--$6.6 billion

-- exclusion of gain on sale of residence--$535 million

-- rollover of gain on sale of residence--$1 billion

TAX-EXEMPT MARKET

Let me turn now to the second part of my testimony -- a discussion of the effects of this mortgage revenue bond financing on the municipal bond market. I'll begin with some background on that market.

The market for the securities of state and local governments is enormous and complex. Volume in the municipal market has expanded considerably in recent years, doubling since 1974. Specifically, a total of $70 billion in short- and long-term debt was sold in over 8,000 separate issues in 1978. Of this amount, $48.5 billion represented long-term municipal debt. Outstanding municipal debt at 1978 year end totalled $301 billion.

Support for the tax-exempt market historically has come primarily from three sources: commercial banks, fire and casualty insurance companies, and individual investors. At the end of 1978, commercial banks held approximately 41 percent of outstanding municipal debt, individuals owned 30 percent, and fire and casualty insurance companies held 19 percent.

The ability of these financial institutions to support a significantly expanded tax-exempt market in the future is questionable in view of the historical record of their purchasing patterns. For instance, during periods of tight monetary conditions such as in 1969, 1974, and 1975 net bank purchases of tax-exempt securities dropped sharply. Similarly, fire and property casualty insurance companies have not been consistent buyers, as their need for tax-exempt income drops during the phase of their underwriting cycle when losses are incurred. Thus, insurance company purchases of tax-exempts declined significantly from prior levels in 1968 and 1969, and again in

1974 and 1975. In the absence of institutional purchasers, yields rose considerably in order to attract individual investors, although interest rates in general were trending higher during those periods.

Potential Growth of Mortgage Revenue Bonds

In assessing the potential impact of mortgage revenue bonds on the market for municipal securities, the size of the overall mortgage market is a vital consideration. Gross mortgage originations in 1978 amounted to approximately $176 billion. Such originations have grown more rapidly than the tax-exempt market in the past, tripling in size from $35 billion in 1970 to $110 billion by 1976, while the municipal market barely doubled in volume during the same period. It is clear that there is an ample potential supply of mortgages to be financed, despite the higher interest rate levels of recent months.

While only comprising a modest share of the municipal market earlier in the decade, financing of housing, including multi-family housing, grew to 11 percent of that market last year. Of that amount, two-thirds constituted single family mortgages financed by state housing agencies and local governments. During the first four months of 1979 mortgage revenue bond financing by state and local governments was in excess of $3 billion, or 25 percent of total long-term municipal debt issued. At least another $3 billion of housing bonds were in the process of coming to the market in the second quarter when H.R. 3712 was introduced.

The municipal bond market has not yet been disrupted by these securities, because only 5 states have issued substantial amounts of them, and another 8 states have authorized, but not issued, mortgage subsidy bonds -- several of them after the introduction of H.R. 3712. Yet, major future growth in issuance of these bonds is expected by the financial community, by the Administration, and by the Congressional Budget Office, because:

-- Given the size of the mortgage market and the substantial interest savings, potential demand for this type of financing exists.

-- Mortgage subsidy bonds may constitute a superior credit, thereby appealing to investors.

-- Institutional investors have indicated a preference for revenue bonds like these, rather than the more traditional general obligation debt.

-- More fundamentally, if the Congress rejects H.R. 3712 other states may regard that rejection as an authorization to proceed.

Concerning credit quality, over 90 percent of the single family mortgage revenue bonds issued to date have been rated AA or better by either Moody's or Standard and Poors. According to Moody's, 80 percent of municipalities are rated A or less. Thus, it appears that substantial differences in quality exist.

Regarding investor preferences, since the New York City financial crisis in 1975, some institutional investors have indicated a preference for revenue debt because of the uncertainties associated with some general obligation issues, particularly those of the nation's older cities. These uncertainties include a lack of timely financial information, as well as dependence on state and Federal aid as opposed to own source revenue. Revenue bonds, including mortgage revenue bonds, tend to be more readily analyzable and thus more preferable than general obligation debt.

Unless limited by Congress, therefore, we think that additional states will authorize mortgage revenue bond financing which will cause dislocations in the municipal market.

Potential Disruption in the Municipal Bond Market

Specifically, such disruptions might mean:

-- Crowding out of other housing debt -- Other housing debt issued by state agencies, including Section 8 and multifamily debt for low and moderate income families, would be forced to pay higher interest rates because they must compete with single family mortgage debt, which carry higher credit ratings, for funds. Increased interest costs may make some projects financially unfeasible.

-- Crowding out of marginal borrowers -- All marginal borrowers, as well as smaller municipalities whose economies are less than robust, will have difficulty borrowing at reasonable interest rates. Marginal borrowers will have to compete with mortgage revenue bonds, which have better credit ratings,

for funds. Further, institutions will tend to prefer to invest in revenue debt at the expense of general-obligation debt. Because marginal borrowers tend to be interest rate sensitive, they will most likely be shut out of the market altogether.

-- Crowding out of regional borrowers -- Regional borrowers will be affected as well, particularly those of smaller size. Smaller issues are generally sold within a given state, or in some cases in neighboring states. They are difficult to market out of state because their credit quality may be unknown and their small size a disadvantage. Sixty percent of the issues of securities by local governments in 1978 only amounted to $2.5 million or less. The purchasers of this type of debt include local banks and individuals. Significantly higher interest rates will have to be offered by regional borrowers in order to attract investors. A more likely possibility, however, is that, because regional borrowers, like most municipal governments, are interest rate sensitive, they will be barred from the market place altogether.

Industrial Revenue Bonds

In conclusion, let me remind you of the similar situation that confronted the Congress in 1968, when it acted to deny tax exemption to large private corporations. As you may recall, over 40 states by the late 1960's had authorized extension of their tax-exemption privilege to industrial firms. The resulting expansion in tax-exempt financing for this purpose created the same problems we are facing today -- a substantial revenue loss for the Federal Government, a lack of Federal control over the subsidy level, and a threat to the stability of the municipal market.

In the debate on the industrial revenue bond issue, Senator Ribicoff, who supported the elimination of tax exemption for private corporations, stated the issues so clearly that I think it is worthwhile to quote him today.

> The Federal Government's concern is obvious. The benefits received by the private corporation in the form of lower rental payments represent nothing more than an unauthorized Federal subsidy to private industry. The total cost of this subsidy -- which is exclusively attributable to the interest exemption intended to help our State and local governments -is borne by other Federal taxpayers....

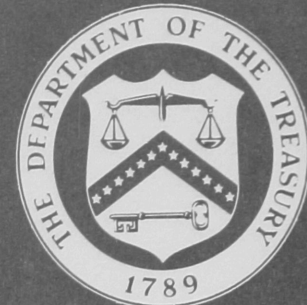
> Unlike most Federal programs, the Federal expenditure is not a part of the Federal budget, was never passed on by Congress, and is not even subject to review by a Federal agency....
>
> However... as more and more tax-exempt bonds are issued the interest rate on all tax-exempt bonds, including school bonds, water and sewer bonds, will increase in order to make the total supply of exemption bonds attractive to lower bracket taxpayers. Thus, the cost of local government goes up.

Because it illustrates the current problem so well, I would like to submit for the record Senator Ribicoff's entire statement, which appeared in the Congressional Record on November 8, 1967.

It is the Administration's view that the Congress must recognize the importance of eliminating mortgage revenue bonds now, as it did in 1968 by limiting industrial development bonds, and again in 1969 by eliminating arbitrage bonds.

In conclusion, I thank you for your attention and I am prepared to answer any questions you may have.

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



FOR RELEASE AT 4:00 P.M. July 17, 1979

TREASURY TO AUCTION $3,000 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $3,000 million of 2-year notes to refund approximately the same amount of notes maturing July 31, 1979. The $3,010 million of maturing notes are those held by the public, including $1,185 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 $170 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 security 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.

oOo

Attachment

B-1730

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC OF 2-YEAR NOTES TO BE ISSUED JULY 31, 1979

July 17, 1979

Amount Offered:	
To the public	$3,000 million
Description of Security:	
Term and type of security	2-year notes
Series and CUSIP designation	Series V-1981 (CUSIP No. 912827 JU 7)
Maturity date	July 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 auctio
Interest payment dates	January 31 and July 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, July 24, 1979, by 1:30 p.m., EDST
Settlement date (final payment due)	
a) cash or Federal funds	Tuesday, July 31, 1979
b) check drawn on bank within FRB district where submitted	Friday, July 27, 1979
c) check drawn on bank outside FRB district where submitted	Friday, July 27, 1979
Delivery date for coupon securities.	Monday, August 6, 1979

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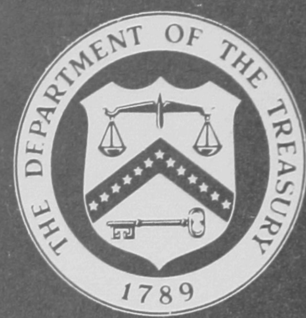

FOR RELEASE UPON DELIVERY
EXPECTED AT: 10:00 A.M. EDT
THURSDAY, JULY 19, 1979

STATEMENT BY GARY C. HUFBAUER
DEPUTY ASSISTANT SECRETARY
OF TREASURY FOR
TRADE AND INVESTMENT POLICY
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
OF THE
SENATE COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman, I am pleased to join in support of the President's request to extend the emigration waiver authority for Romania and Hungary under Section 402 of the Trade Act of 1974. The Department of the Treasury endorses the President's determination that further extension of the emigration waiver authority for Romania and Hungary will substantially promote the objectives of Section 402. The waiver authority permitted us to sign bilateral trade agreements with Romania and Hungary in April 1975 and March 1978, respectively, thereby laying the basis for growing trade and closer relations. Continuation of this authority will provide a basis for

B-1731

future expansion and improvement of bilateral relations with other countries, subject to the provisions of Section 402.

Extension of the waiver is necessary for Romania and Hungary to continue using official U.S. Government financing for imports from the United States. Officially-supported export trade finance has been one of the mechanisms used by governments to encourage exports, particularly in this era of aggressive export competition among the industrialized countries. In the absence of the waiver, the Export-Import Bank would be unable to make loans or guarantees, and U.S. exporters would thus operate at a competitive disadvantage. Commodity Credit Corporation (CCC) credits, which have been instrumental in increasing U.S. agricultural exports, particularly to Romania, also cannot be extended without the waiver. Both forms of financing greatly benefit U.S. exporters, and ultimately the United States' balance-of-payments position.

To be able to earn hard currency, Romanian and Hungarian exporters must have access to Western markets. If the United States does not continue to facilitate access to U.S. markets through most-favored-nation tariff treatment for Romanian and Hungarian products, the U.S. may lose potential exports to these countries. The President's waiver will

enable us to continue extending MFN, thereby enhancing the ability of Romania and Hungary to earn hard currency, which they can use to purchase American goods.

Romania

When Secretary Blumenthal, acting at the request of President Carter, visited Romania last December, he underscored the importance which our two nations attribute to closer U.S.-Romanian ties. We believe that is in our national interest to encourage Romania's independent policy orientation through further expansion of bilateral relations. Extension of the waiver for Romania will foster improved relations and promote the objectives of Section 402 of the Trade Act.

The expansion of our commercial relations in recent years can be attributed to the efforts of both governments to construct a viable framework and favorable atmosphere in which trade and economic cooperation can develop. The U.S.-Romanian Trade Agreement is one joint effort which has contributed substantially to the growth of bilateral trade. Total trade turnover has grown from $322 million in 1975, which was four times the value of trade in 1970, to a record $664 million last year. The U.S. maintained a positive trade balance during the years prior to 1978, and recent data reveal a U.S. trade surplus of $82.5 million for the first five months of 1979.

Aided by official financing, American exports to Romania for the first five months of this year are $80.6 million ahead of the same period in 1978. The Commodity Credit Corporation (CCC) has extended $110 million in credits in fiscal year 1979, compared to only $23 million in 1978. Eximbank exposure in Romania (as of March 31, 1979) is about $100 million. The few instances of threatened market disruption from Romanian imports have been resolved.

We are aware of Congressional concern regarding a Romanian decree which sets arbitrary limits on compensation for confiscation of U.S. property in Romania. The Administration shares these concerns. We are pleased to note that two cases involving this decree were effectively resolved earlier this year with the payment of compensation to American claimants. The U.S. Government has presented five additional cases to the Government of Romania and has received assurances that processing of these and the one outstanding case will continue.

Hungary

The Administration vigorously supports the expansion of American-Hungarian economic and commercial contacts, which have been facilitated by the bilateral trade agreement. We believe that these contacts will serve to encourage an

independent Hungarian foreign and economic policy. In February of this year, Secretary Blumenthal and the Hungarian Finance Minister signed a bilateral tax treaty which, having been ratified by the Senate, will enter into force once the countries notify each other that the treaty has been approved. The tax convention will encourage further economic and cultural exchanges by clarifying tax rules, reducing taxes at source, avoiding double taxation, and providing for administrative cooperation in implementing the treaty.

The notable increase in total U.S.-Hungarian trade over the past decade illustrates the potential for mutually beneficial economic and commercial cooperation. U.S.-Hungarian trade turnover was a mere $11 million in 1967. Trade has increased steadily since that time (with the exception of 1975), and reached a high of $166 million in 1978. Throughout this period of expanding trade, the United States has consistently sustained a positive annual trade balance.

Last summer, the Treasury Department initiated an investigation under the Antidumping Act of lightbulbs imported from Hungary and allegedly sold in the U.S. at less than fair value. The International Trade Commission determined in September that there was no reasonable indication of injury, or potential injury, in the United

States caused by these Hungarian imports. Consequently, the Treasury terminated its investigation. Since that time, Action Industries, the U.S. importer of Hungarian lightbulbs, has begun to manufacture lightbulbs domestically in a joint venture production arrangement. The operation is the first production joint venture in the United States with participation by an East European firm.

Although Hungary is more self-sufficient in agriculture than other East European countries, CCC credits are playing an increasingly important role in our bilateral trade. In fiscal year 1979, $42 million in CCC credits were made available to Hungary to finance agricultural sales, principally of soybean meal and cotton. These credits could encourage Hungary to purchase other U.S. agricultural commodities. Eximbank is hopeful that it can commence financing Hungarian industrial projects later this year.

In conclusion, Mr. Chairman, I believe that a one-year extension of the Presidential waiver for both Romania and Hungary will serve our national interest.

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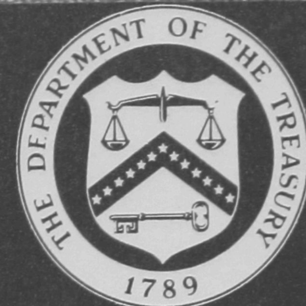

FOR IMMEDIATE RELEASE
July 17, 1979

Contact: Jack Plum
Phone: 202/566-2615

TREASURY ANNOUNCES RESULTS OF GOLD SALE

The Department of the Treasury announced that 750,000 troy ounces of fine gold were sold today to 10 successful bidders at an average price of $296.44 per ounce.

Awards were made in 300 ounce bars whose fine gold content is 39.9 to 91.7 percent at prices ranging from $295.11 to $296.76 per ounce. Bids for this gold were submitted by 19 bidders for a total amount of 2.1 million ounces at prices ranging from $110.00 to $296.76 per ounce.

Gross proceeds from the sale were $222.3 million. Of the proceeds, $31.7 million will be used to retire Gold Certificates held by Federal Reserve Banks. The remaining $190.7 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 the details of the individual awards to successful bidders.

The current sale was the fifteenth 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 August 21 at which 750,000 ounces of gold will be offered in bars whose fine gold content is 39.9 to 91.7 percent. The minimum bid for these bars will be 300 fine troy ounces.

B-1732

		OUNCES
BANK LEU LIMITED NEW YORK	NY	4800
CREDIT SUISSE ZURICH	SWITZERLAND	900
DERBY AND COMPANY LTD LONDON	ENGLAND	19300
DRESDNER BANK FRANKFURT	W.GERMANY	672000
J ARON AND COMPANY INC NEW YORK	NY	15900
REPUBLIC NATIONAL BANK OF NY NEW YORK	NY	19300
SAMUEL MONTAGU LIMITED LONDON	ENGLAND	3000
SBC FINANCIAL LIMITED MONTREAL	CANADA	900
SWISS BANK CORPORATION ZURICH	SWITZERLAND	3900
UNION BANK OF SWITZERLAND ZURICH	SWITZERLAND	9000

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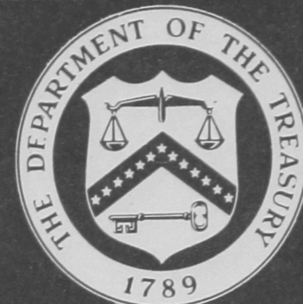

FOR IMMEDIATE RELEASE July 18, 1979

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $3,380 million of 52-week bills to be issued July 24, 1979, and to mature July 22, 1980, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: (Excepting 2 tenders totaling $2,500,000)

	Price	Discount Rate	Investment Rate (Equivalent Coupon-issue Yield)
High -	91.027	8.874%	9.68%
Low -	90.978	8.923%	9.74%
Average -	91.005	8.896%	9.70%

Tenders at the low price were allotted 17%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 37,970	$ 27,970
New York	4,436,885	2,881,615
Philadelphia	2,310	2,310
Cleveland	6,795	6,795
Richmond	50,665	50,665
Atlanta	65,050	65,050
Chicago	345,015	232,015
St. Louis	34,470	9,470
Minneapolis	3,585	3,585
Kansas City	9,585	9,585
Dallas	2,070	2,070
San Francisco	198,550	79,550
Treasury	9,355	9,355
TOTALS	$5,202,305	$3,380,035
Type		
Competitive	$3,915,070	$2,092,800
Noncompetitive	112,555	112,555
Subtotal, Public	$4,027,625	$2,205,355
Federal Reserve and Foreign Official Institutions	$1,174,680	$1,174,680
TOTALS	$5,202,305	$3,380,035

B-1733

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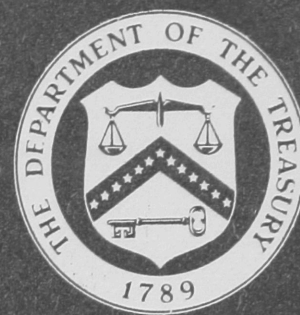

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STATEMENT OF THE HONORABLE DONALD C. LUBICK
ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
OF THE INTERNAL REVENUE SERVICE
OF THE SENATE COMMITTEE ON FINANCE

Mr. Chairman and members of the Subcommittee:

I am pleased to present today the views of the Department of the Treasury with respect to S. 1444, "the Taxpayer Protection and Reimbursement Act." This bill provides for the reimbursement of attorney fees to prevailing parties in tax cases where the Government's position in the litigation is found to be unreasonable. The Treasury Department supports S. 1444.

CURRENT LAW

We recognize at the outset that S. 1444 departs from the general procedures for payment of attorney fees in our court system. Under the so-called "American rule," each party in litigation ordinarily pays his own legal fees whether the case involves private litigants or the Government. Congress has created a few statutory exceptions to the "American rule." For example, a victorious party can recover attorney fees under the Civil Rights Act of 1964, the Freedom of Information Act, and the Consumer Product Safety Act. But most provisions for fee shifting are designed to encourage private citizens to enforce rights that transcend the interests of the litigating parties -- a rationale that rarely applies in tax cases.

Current law does contain an ambiguous provision for awarding attorney fees in tax litigation. The Civil Rights Attorneys' Fees Awards Act of 1976 provides judicial discretion to grant attorney fees to a prevailing party (other than the United States):

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> "...in any civil action or proceeding, by or on behalf of the United States of America, to enforce, or charging a violation of, a provision of the United States Internal Revenue Code...."

Interpretation of this quoted language has been the subject of controversy in Congress and the courts.

With respect to two basic issues, the courts have determined that the statute has a narrow application. First, virtually all the cases have held that attorney fees can be awarded only if the taxpayer is the defendant. This interpretation results in the statute being applied to very few cases; most tax litigation occurs in the Tax Court where the taxpayer is the petitioner or in a District Court where the taxpayer is the plantiff suing for a refund. Second, the courts have cited legislative history to conclude that taxpayers must demonstrate that the Government has acted "in bad faith, for purposes of harassment or vexatiously or frivolously."

In our view, current law is unacceptable. The ambiguities in the 1976 Act are troubling, and the Act has been held to apply to such an arbitrarily narrow category of cases that it provides more confusion than protection for taxpayers. The tax provision of the Civil Rights Attorneys' Fees Awards Act should be repealed.

OBJECTIVES OF NEW LEGISLATION

Some persons may argue that this Subcommittee should take no action beyond repeal of the tax provision in the Civil Rights Attorneys' Fees Awards Act. As we have noted, a Federal tax case is not, in general, the type of litigation in which attorney fees historically have been awarded; tax litigation seldom involves a "private attorney general" seeking to establish social principles for the public at large. In fact, an attorney fees statute presents the danger of impairing the interests of the vast majority of taxpayers. A recent comment by the Tax Section of the New York State Bar Association is instructive:

> "...[I]t must be recognized that in legal disputes right and wrong are often matters of degree, or of fact; that a system that encourages the settlement of cases may be as desirable as one that pushes cases to trial; that the allowance of attorneys' fees may induce either more litigation or more prolonged litigation; and that any increased litigation expenses of the Government will ultimately be borne by all taxpayers." Tax Section, New York State Bar Association, Report of the Committee on Practice and Procedure, "Awards of Attorneys' Fees in Federal Tax Cases," January 18, 1978.

However, in spite of the potential problems with awarding attorney fees in tax cases, we favor a provision for fee shifting in certain instances. The issue must be faced squarely: when should the legal fees of one taxpayer be paid by all taxpayers? In addressing this question, we believe that legislation should be designed with several general objectives in mind.

Protection of Taxpayers Against Government Abuses

Any attorney fee proposal should be examined in the context of our self-assessment method of taxation. The American tax system is unique in the extent to which it depends upon voluntary compliance. The Government relies upon individual taxpayers to assess themselves and to pay their share of the tax burden. In return, taxpayers expect the Government to administer the system fairly and even-handedly.

We believe that the Government usually lives up to its end of the bargain. The Internal Revenue Service generally administers the tax laws reasonably and equitably. But in any institution as large as the IRS, some mistakes are made. In those instances where the Government overreaches, a taxpayer must not feel incapable of defending his interests. The awarding of attorney fees in appropriate cases can help to preserve the principle of fairness that is central to the voluntary assessment system.

Encouragement of Responsible Government Action

The attitudes and actions of Government employees, as well as taxpayers, may be affected by attorney fees legislation. Proponents of such legislation usually suggest the

need to restrain the Federal bureaucracy. Accordingly, an attorney fees bill is advanced as a deterrent to heavy-handed actions by the Internal Revenue Service.

In order to achieve this deterrent objective, legislation should distinguish between abusive and responsible governmental actions. Tax administration would obviously be ineffective if the Government conceded all close cases to taxpayers. Reasonable pursuit of debatable tax issues should not be discouraged by enactment of an attorney fees bill that applies broadly to all prevailing taxpayers.

Concern for Tax Court Congestion

Moreover, a bill that is drafted too broadly would encourage litigation and increase substantially a volume of tax cases that is already alarming. The current Tax Court inventory is at an all-time high of over 24,000 cases. Such a huge case load places a strain upon the Government's ability to dispose effectively of a case and impairs the ability of a taxpayer to obtain prompt judicial resolution of a dispute.

Congress has acted recently in an effort to alleviate this court congestion and to assist small taxpayers. The Revenue Act of 1978 expands a special Tax Court small case procedure, originally created in 1969. Effective June 1, 1979, the Act permits an informal, expedited process for handling disputes where $5,000 or less is at issue; the prior jurisdictional ceiling was $1,500. Nearly all of these cases are handled by the taxpayers themselves, without the need to hire counsel. In describing this recent amendment, the General Explanation of the Revenue Act of 1978 states:

> "[M]ore taxpayers will be able to take advantage of that expeditious and simplified procedure for handling tax disputes. In addition, it will provide a means of relieving the regular judges of part of an extremely heavy workload."

If attorney fees were to be awarded routinely to prevailing taxpayers, we fear that use of the simple small case mechanism would be discouraged. Attempts to streamline Tax Court procedures would be undermined. And in the process, the ultimate losers would be the thousands of taxpayers who desire swift judicial decisions on tax controversies.

APPROACH OF S. 1444

Measured by the objectives I have outlined, S. 1444 is a good bill. Its scope is more expansive and rational than current law. Yet, its language is well tailored to accommodate the unique characteristics of tax cases.

To recover attorney fees under S. 1444, a litigant must show that the position of the Government in the litigation is unreasonable. This standard promotes the sound principle that taxpayers should not have to bear the cost of defending themselves against abusive governmental action. But at the same time, it recognizes the interest of all taxpayers in responsible tax administration by the IRS and in having an expeditious judicial remedy for cases not settled at an administrative level.

The "reasonableness" test is to be applied by "taking into account the entire record of the case as well as any other relevant evidence." Under this standard, the attorney fees issue should be viewed in the context of the history of litigation on a particular tax question. For example, a court might award attorney fees where the Government continues to litigate a legal issue after losing in several Circuit Courts. On the other hand, attorney fees should not ordinarily be granted where a decision invalidates an IRS ruling that had previously been upheld by other courts.

In outlining the requirements for recovering attorney fees, the bill recognizes that tax cases, compared to other forms of civil litigation, typically involve many differing issues of fact and law as well as several taxable years. There is likely to be no clear-cut winner in such a multi-faceted proceeding; approximately 40 percent of all Tax Court cases result in decisions that are split between the taxpayer and the Government. Accordingly, S. 1444 describes with some precision the extent to which a party must prevail in order to qualify for an award. Under the bill, a party must prevail with respect to all, or all but an insignificant portion portion of, the amount in controversy. If no amount is in controversy, the taxpayer must prevail with respect to all, or all but an insignificant portion of, the issues involved.

We believe that the definition of "prevailing party" in S. 1444 -- a definition that incorporates the "reasonableness" standard and the specific treatment of multiple issue proceedings -- should allay many of the concerns about exacerbating court congestion in tax cases. But to discourage unnecessary litigation, the Subcommittee may wish to consider an additional refinement of the requirements for recovery of legal expenses. Under current practices, a taxpayer typically appeals to an IRS regional office in the event he disagrees with the findings of an examining agent; over 95 percent of all disputed cases are resolved without trial. If the bill is enacted as drafted, there is a danger that a taxpayer will circumvent the administrative process and have his case docketed in court solely because of the prospect of recovering attorney fees and other court costs. As a safeguard against such unintended results, we recommend that the bill allow attorney fees to be recovered only in those instances where a taxpayer has exhausted his administrative remedies before instituting court proceedings.

Finally, we would like to note another provision in the bill that reflects the unique aspects of tax cases. Contrary to most other forms of litigation, the complexity of a tax case is generally related to the relative affluence of the taxpayer. Most persons with modest resources can litigate their tax issues without incurring the legal fees that might be paid by a large, multinational company. Therefore, to target relief to those most in need, H.R. 1444 places a ceiling of $20,000 on the amount of costs and attorney fees that can be awarded in any one proceeding. This cap is a workable limitation that focuses the bill on small taxpayers without requiring a judicial determination of asset size -- a determination that could itself raise difficult fact questions for a court.

S. 1444 takes a reasonable, balanced approach to the special problems of awarding attorney fees in tax litigation. The bill is scheduled to be effective for a 4-year period, so that its impact can be carefully evaluated before permanent legislation is adopted. This experiment should be undertaken. We urge enactment of S. 1444.

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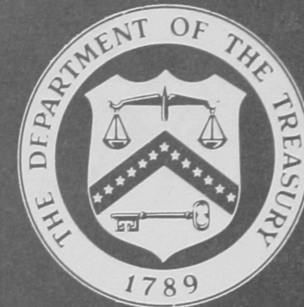

FOR IMMEDIATE RELEASE
July 18, 1979

Contact: George G. Ross
202/566-2356

TREASURY ANNOUNCES PUBLIC HEARING ON
BUSINESS HOLDINGS OF PRIVATE FOUNDATIONS

The Treasury Department today announced that a public hearing will be held on September 6, 1979 concerning proposed regulations governing excess business holdings of private foundations, which were published in a notice of proposed rulemaking on May 22, 1979.

Treasury also announced that, to the extent that any rules as finally adopted are more stringent that the rules proposed in 1973, the effective date will be no earlier than December 31, 1979. As published on May 22, 1979, the proposed regulations would have been applicable to transactions taking place on June 22, 1979 and thereafter.

The Tax Reform Act of 1979 placed limitations on foundation ownership and control of active businesses, but provided certain exceptions for then-existing holdings. The regulations proposed in 1973 would extend grandfather protection to certain changes in business holdings acquired by foundations through merger or other reorganizations involving stock held on May 26, 1969. Grandfather protection proposed in the 1979 notice would be less extensive than that proposed in 1973.

Concern has been expressed about the effect of the new proposed rules on what is described as normal expansion of business corporations in which a private foundation has a grandfathered holding. The public hearing in September 1979 will determine whether the final regulations should embody the rules of the January 3, 1973 notice of proposed rulemaking resulting from the Tax Reform Act of 1969, the proposed rules of the May 1979 notice, or an intermediate position.

Comments are requested as to both notices, and respondents are urged to set forth any alternative rules they would recommend. Comments, as well as requests to speak at the September 6, 1979 hearing, should be sent by August 22, 1979 to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-162-78), Washington, D.C. 20224.

To the extent that any rules finally adopted are more stringent that those in the 1973 notice, the rules will not apply to transactions taking place prior to ninety (90) days after the publication of the Treasury decision setting forth the final regulations, or December 31, 1979, whichever is later. Consideration also will be given to additional rules needed to protect transactions in progress at the time of the Treasury decision.

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S U E R F

COLLOQUIUM

May 10-12, 1979

Basle

EUROPE AND THE DOLLAR IN THE WORLD-WIDE DISEQUILIBRIUM

L'EUROPE ET LE DOLLAR DANS LE DESEQUILIBRE MONDIAL

"The Changing Role of the United States in the World Economy"

Daniel H. Brill
Assistant Secretary of the Treasury for Economic Policy
Washington, D.C., USA

I find the title for the colloquium puzzling, pejorative, challenging, frustrating. What is "the worldwide desequilibrium"? Do disparate trends among nations in the balance of their international trade and service transactions constitute "disequilibrium"? Do long-standing differences among nations in their savings and investment propensities constitute "disequilibrium" when these differences are manifested in their current and capital accounts? Is it "Disequilibrium" if exchange rates adjust to reflect these disparate trends and tendencies? The very term"disequilibrium" suggests to me that some analysts still cling to the notion of an ideal static state of international economic relationships from which deviations threaten to shake the world loose from its economic moorings.

I favor a more dynamic interpretation of international events, one which views change as an inevitable and evolutionary process--although not always to beneficial ends. In this context, disequilibrium can exist if social, economic or political barriers prevent--or seriously delay--adjustment to change, thereby forcing, in the end, an abrupt or violent adjustment. Alternatively (and subjectively), I would class as disequilibrating a change

which leaves the world poorer than it need be as a result of adjustment to the change.

It is within the context of these interpretations of disequilibrium that I propose to explore some aspects of the impact of U.S. developments on the world economy. Has U.S. economic policy and performance tended to stabilize or destabilize the global economy? Has the effectiveness of the United States as a global economic flywheel diminished? Of course, from an American viewpoint, it is equally important to ask whether external events have had an increasingly destabilizing effect on the United States.

This is a vast subject, far too broad to be encompassed in a single paper. I will limit my observations, therefore, to certain developments in trade, capital flows and international monetary reserves that may have contributed to equilibrium or disequilibrium in the sense these terms are defined above.

The U.S. Role in World Trade

Various criteria--financial and nonfinancial--can be used to measure the influence of any one economy on the course of global economic developments. Relative size of output is one such measure; while imperfect and inadequate, it is not an insignificant factor. Equally, if not more

important, is the extent of a country's participation in world trade. Size alone may offer potential influence, but if a country's trade links to the world are relatively small, it lacks the means of transmitting--at least through economic channels--the influence its size might confer, or of being influenced significantly by developments abroad. Thus, the extent to which any nation can contribute to world economic stability is a function of both its relative size and its relative "openness".

In the 1940's, 1950's, and through the early 1960's, the ability of the United States to exert strong influence on the world economy stemmed primarily from its preponderant share in world output. Even though, as a result of the relative self-sufficiency of the American economy, the U.S. propensity to import was probably lower than that in the rest of the world, the sheer size of the U.S. market made the fortunes of many foreign economies dependent on that of the United States. Expansions in the U.S. led to increases in exports by other countries and, via foreign trade multipliers, to noticeable upswings in their domestic economic activity.

In large measure, this reflected relative economic positions at the end of World War II. With many of the world's industrial economies in disarray, the share of the United States in global output was overwhelming.

Accurate statistics for this period are not available, but if one roughly takes into account output generated and exchanged outside the market in the then still disorganized economies of Europe and Japan, in the mid-1940's the United States produced probably more than one-half of total world output.

As the recovery of other World War II participants progressed, the U.S. share of global GNP declined. By 1955, U.S. share of world output amounted to about 36 percent, while the share of the countries which later became members of the Common Market stood at about 18 percent of the world output.

Throughout the fifties, the growth rates in U.S.--while on average impressive by U.S. historical standards--still lagged behind those in other industrial countries, and the U.S. share in world output kept declining, albeit not as abruptly as in the first post-war decade. By 1960, the U.S. share had fallen further to about one-third of the world's output. Japan, Communist countries, and, to a lesser extent, Western Europe were gaining in relative terms.

In the 1960's, even though U.S. growth accelerated, growth in other industrial countries increased even more rapidly. By 1965, the U.S. share fell to about 31 percent while the share of EEC countries rose to 19 percent of the

world output. Japan began by that time its dash for economic growth that increased its share from slightly over 2 percent in 1955 to almost 4 percent in 1965.

In the next five years the United States' share declined by a fraction of a percentage point, the share of the European Community rose to almost 20 percent, and the share of Japan exceeded 6 percent. Relative losers in the late 1960's were Communist countries and LDC's.

Overheating of the U.S. economy, as in the early 1950's and, again, in the late 1960's, coincided with investment binges abroad, sharp increases in commodity prices, and other symptoms of economic fever. Conversely, the slumps of the fifties (and, to a lesser extent the slowdown of 1966) brought about periods of marked deceleration of growth in the economies of U.S. major trading partners. On the whole, however, throughout the quarter of a century following World War II the U.S. had a remarkable record of relatively stable, albeit not spectacular economic growth that contributed to the stability of the world economy.

Accompanying the growth in world output during this period was an even more rapid growth in the commerce among nations. In the 1960's, for example, world output increased at an annual rate of 5 percent while world trade grew by 8-1/2 percent per year.

The increase of world trade relative to world output reflected a general, country-by-country increase of trade ratios. For example, trade turnover (exports plus imports) as a percentage of U.S. GNP has increased from around 7 percent in the mid-1950's to over 15 percent last year. Figures for other industrial countries show a similar, though perhaps not so striking, pattern. For Japan, and France, the ration of trade to output increased by only 3 or 4 percentage points, but for each country there was a significant increase in the part of national output which entered into world trade.

The "openness" of the U.S. economy has grown appreciably only in recent years. Throughout the 1950's and 1960's U.S. exports and U.S. imports both remained small, stable proportions of GNP, about 4.0 and 3.0 percent respectively. Beginning in the mid-1970's, however, the two measures of openness for the U.S. economy evidence sizeable increases. By 1978, the ratio of U.S. exports to GNP increased to 7.0 percent, while the ratio of imports to GNP advanced to 9.0 percent. This increase of U.S. openness is remarkable because it represented a growth in "two-way" interdependence. The rise in imports relative to GNP of the U.S. was in pace with the rise in the export share.

Historical data assembled by Simon Kuznets indicate that the tendency toward increased openness of the economies of the industrial countries is not a new phenomenon. His data show that from 1800 to 1913 foreign trade (exports plus imports) increased from 3 percent to almost 33 percent of world output. As we already observed for recent years, over the historical long-run the tendency toward increased openness in merchandise trade has been widespread, and not confined to a handful of large or rapidly growing countries.

Viewed then in this perspective, the expansion of world trade is a resumption of an historical trend which was "temporarily" interrupted by two world wars and a worldwide depression.

But the structure of trade, or more particularly, the structure of the growth of trade is different now than it was in the late 19th and early 20th century.

First, there is the rapid increase of intra as opposed to inter-industry trade between developed countries. By the mid-1970's, almost $65 of every $100 of manufactured goods traded internationally by industrial countries was exchanged within industries, i.e., exports by one country matched by imports by that country of products produced in

the same industry. While the volume of trade among industrial countries is continuing to increase, lines of specialization among industrial countries are becoming less clear.

A second important difference between the 19th century and the current growth of trade involves the role of the developing countries. During the 19th century there was a relatively clear distinction between industrial and non-industrial countries. Trade between them tended to be the text-book exchange of materials for manufactured goods. The recent growth of world trade is accompanied by the increasing production and export of manufactured goods by developing countries. In 1978, 24 percent of U.S. manufactured imports originated in LDC's, while in 1965, the figure was 14 percent.

Among industrial countries specialization is basically among firms, not among countries. Differences in technology are probably as important among firms in the same industry but in different countries as they are among different industries in different countries. Between such firms, specialization is based on economies of a scale according to particular product varieties. In this sense, trade among the industrial countries is becoming

more like commerce within them. In the early stages of development, firms in the LDC's tend to produce standardized products and to base their position in the market on access to cheap inputs, particularly labor. But as LDC's enter more advanced stages of development, there is a tendency to move output up to more sophisticated, less standardized product, and to enter into the kinds of competition typical of that among industrial countries.

One final set of observations before pulling together the strands of the discussion of trends in trade. Most analyses indicate a greater response of U.S. imports than of exports to fluctuations in income. The higher import elasticities are well established in the econometric literature, although one must suspect that the income variable is a surrogate for other factors that cannot yet be identified separately or measured well. But even if the values attributed to the influence on imports of U.S. income fluctuations tend to be overstated, they clearly are larger than the influence of foreign income changes on U.S. exports. In fact, there is evidence that U.S. demand for foreign products has even become more sensitive to the growth of U. S. output, especially following the Vietnam war, while the estimated responsiveness of U. S. exports to changes of foreign growth has remained relatively stable.

There is no evidence that foreign "elasticities" have changed to U.S. income developments in the post-war period. The U.S. has, more or less year-by-year since 1952, absorbed 7 percent to 8 percent of Western European countries' exports. The share of Japanese exports destined for the U.S. is about the same now as it was in the mid 1950s (though this ratio has varied more than the ratio for U.S. imports from Western Europe). While the share of the oil producers' exports to the United States has remained stable, at a bit over 25 percent during the 1970s, the share of their exports shipped to the U.S. by non-oil producing LDC's jumped from 10 to 25 percent over the same period. But this has been a function of development, not income elasticities.

To summarize these observations on the changing role of the U. S. in world trade: a) U.S. output, while still by far the single largest national component of world output, is a far smaller share of the global economy than earlier in the past war era; other industrial and developing countries, starting from a lower base, have been able to grow more rapidly, b) external trade has become a significantly larger share of U.S. output, particularly in recent years, c) "comparative advantages" in trade have tended to diminish as the diffusion of technologies across borders increases

competition, d) the foreign trade of the U.S. has become quite sensitive to domestic economic conditions, with imports significantly more sensitive than exports.

The implication of these observations is that the ability of the United States to act independently as an international economic stabilizer is much reduced from the role it could play during the postwar reconstruction era. In other words, the U.S. could not, through trade flows, become a global economic "flywheel" even if it wanted to. At the same time, the greater interdependence of the U.S. in the global economy adds to constraints in the development of U.S. economic policies. The constraints on policy formulation become even more binding on the major reserve-currency country in a regime of flexible exchange rates, as was painfully evident in 1978 when the decline in the value of the dollar, in consequence of the large U.S. trade deficits of recent years, added significantly to inflationary pressures in the U.S. economy. These pressures, in turn, reinforced the need for policies to slow the U.S. expansion and restrain inflationary forces. This slowing will reduce the rate of growth in U.S. imports. Thus, the U.S. will not be in a position to

compensate strongly for inadequacies in growth of other industrial nations which may not be fully exploiting their potential.

Of course, the influence of the U.S. on the global economy is exerted through the world's monetary and financial system as well as through trade flows. We turn now to a consideration of the central role the U.S. plays in the international financial system.

The Changing Role of the United States in the International Financial System

I have already noted that the United States contributed to global economic growth in the 1950's and '60s by maintaining a reasonably steady rate of expansion and by participating in the burgeoning of world trade. The United States also promoted world growth by extending substantial amounts of foreign credit, both private and public. Year in and year out, the United States enjoyed trade and, excluding government transfers, current account surpluses with the rest of the world.

These surpluses were, of course, a reflection of other nations' appetite for American goods and services. To the extent that this appetite could be satisfied by American farms and factories, imports from the U.S. played a vital role in the process of the post-war reconstruction and subsequent development of the rest of the world.

Yet this process of transferring real resources from the U.S. to the rest of the world could not be accomplished were it not for the readiness of the United States to "recycle," to use the term of more recent coinage, its current account surplus by investing abroad. Apart from transferring American technology and managerial knowhow, U.S. investment abroad allowed the recipient countries to expand their output and, usually, their exports as well.

The U.S. Government pursued a conscious policy of resource transfers of its own. Beginning with the Marshall Plan, the rest of the world received, during the two post-war decades, tens of billions of dollars in military and civilian grants, rollovers or forgiveness of war debts, soft and hard loans, bilateral and multilateral aid. Relative to the amounts of savings the war-ravaged world was able to generate in the first post-war decade, transfers of public capital by the United States to the rest of the world were very substantial.

Smooth functioning of the world economic mechanism, which made the unprecedented growth in the 1950's and 1960's possible, was contingent in large measure on the willingness of the United States to keep playing the role of banker to the world -- borrowing short-term and lending long-term. Even after pre-World War II levels of output had long since been surpassed, the world enjoyed a decade and more of rapid and sustained economic growth, high levels of employment, expanding international trade and investment, remarkably low rates of inflation by today's standards, and stable exchange rates. The provision of international liquidity through the export of dollar-denominated capital was a potent influence on the degree of ease or stringency of other governments' economic policies and, consequently, on the level of economic activity in the world.

Until the late 1950's, increases in official claims on the United States accounted for close to one-half of all additions to international reserves. In 1959, these claims were equal to over 60 percent of all foreign exchange reserves and constituted over a quarter of all reserve positions in the IMF.

Despite major institutional innovations of the 1960s and 1970s -- increased use of offshore markets by private financial institutions and monetary authorities, introduction of the SDR, and expanded use of Fund-related assets -- the relative importance of the dollar as a reserve currency has remained high. In 1970 official claims of all IMF members on the United States amounted to 53 percent of all foreign exchange holdings and about 25 percent of reserve asset holdings. Even at the end of 1977 these proportions remained virtually unchanged, and this even if gold reserves were valued at current market prices. If Euro-dollars are added to official claims on the U.S., the proportion of dollar-denominated assets in foreign exchange holdings remained stable at around 80 percent through 1977.

Data through the first three quarters of 1978, suggest that there were instances of diversification out of dollars in 1978. During the fourth quarter I suspect there were further shifts out of dollars. But more recent dollar strength clearly suggests a return to dollar reserves.

Even with the strains put on the U.S. balance of payments--indeed, on the world's payments mechanism--by the soaring of oil prices since 1973, the U.S. has continued to perform as an international banker in recycling of oil revenues. From 1973 through 1977, total U.S. liabilities to OPEC countries increased by nearly $39 billion, while U.S. bank claims on foreigners increased almost $66 billion. Since most of these OPEC assets were placed in U.S. Government obligations, the recycling took place through the workings of U.S. domestic financial markets. In this respect, the United States played an important stabilizing role that supplemented the Eurocurrency markets in helping deficit countries finance oil imports.

There are some signs, however, of a changing role for the dollar, at least in the transactions functions it serves. The SDR has begun to assume the role of numeraire alongside the dollar. The dollar is less dominant as a

transactions currency; gradually an increasing proportion of international transactions is being invoiced in other currencies. Similarly, the role of the dollar as the intervention currency is diminishing, especially within what has become the European Monetary System. And, in time, other financial instruments will undoubtedly come to share increasingly the dollar's store-of-value function.

Even though the proportion of dollar-denominated assets barely changed in the 1970's until 1978, there has been some limited tendency toward asset diversification on the part of official holders. This tendency toward diversification has been modest so far. But the IMF has decided on sizable new allocations of SDR's in coming years. And the IMF is also examining the possibility of further strengthening the SDR through a substitution account which might lead to the deposit of some official dollar assets with the Fund in exchange for an SDR denominated instrument.

Diversification of reserve assets in official portfolios may be a natural consequence of evolving economic relationships. But the evolution of new reserve assets to significant size is a slow process, and the dollar's role in contributing to the expansion or contraction of international liquidity will remain paramount for quite some time.

Summary

In the evolution of the postwar world economic order, a number of developments have increasingly limited the ability of the U.S. to determine independently its own economic fate, or to determine single-handedly the course of the global economy. The relatively faster rise in other countries' output, the reduction in the U.S. share of world trade, the rising share of foreign trade in U.S. output, the emergence of strong competitors able to employ contemporary technology but retaining comparative cost advantages, the inception of floating exchange rates, the development--still in its early stages--of alternative reserve assets, all tie the U.S. more closely into the world economy.

At the same time, these developments require that more of the burden of global economic stabilization be shared by other countries, in both the financial and nonfinancial spheres of cooperation. The worldwide impact of rising energy costs, and the accompanying mammoth transfers of claims on wealth give greater impetus to the growth of interdependence, calling for increased coordination of domestic economic policies, as well as increased cooperation in assuring a monetary and financial environment conducive to growth and stability.

Appendix

The source of data that are cited in the text may be found in the appropriate accompanying tables.

The keynote dates may be found in Simon Kuznets, "Quantitative Aspects of the Economic Growth of Nations: Level and Structure of Foreign Trade Long-Run Trends," _Economic Development and Cultural Change_ V. 15 (Jan. 1967) No. 2 part II.

The discussion of intra-industry trade among the developed economies is further examined in, Finger, J.M., and DeRosa, Dean, "Trade Overlap, Comparative Advantage, and Protection," U.S. Treasury Department, Jan. 1, 1979.

Table 1

World Gross National Product [1]

[In billions of U.S. dollars]

	1955	1960	1965	1970	1971	1972 [2]	1973 [2]	1974 [2]	1975 [2,3]
Total	1,100	1,500	2,200	3,200	3,700	4,200	4,900	5,700	5,900
ed States	399	506	688	982	1,063	1,171	1,306	1,447	1,499
ada	27	36	48	80	92	103	119	143	154
n	24	39	85	197	236	335	413	470	526
pean Community	193	263	411	626	763	897	1,057	1,180	1,220
United Kingdom	54	71	99	121	147	151	175	199	224
France	49	58	93	148	177	218	255	232	337
West Germany	43	70	112	186	235	266	348	394	411
Italy	24	32	57	93	108	122	138	150	164

Current prices

Based on average monthly rates of exchange

Estimate

ource: Department of Commerce

Table 2

Recent Trends of Exports Plus Imports as a Proportion of National Production of Major Trading Countries at Current Prices

(Percentages)

Year	United States	United Kingdom	France	Germany	Italy	Japan
1955	7	26	20	28	19	19
1960	7	23	22	30	24	20
1965	7	30	21	31	25	19
1970	9	33	23	34	28	19
1975	15	42	--	39	--	23

Source: IMF International Financial Statistics, May 1976, Feb. 1977.

a/ 1952 figure.

Historical Trends of Exports Plus Imports as a Proportion of National Production of Major Trading Countries at Current Prices

(Percentages)

Year	United States	United Kingdom	France		Germany		Italy	Japan
19th Century	13	22	18 b/		37 d/		21	10
Pre World War I	11	44	54 d/		38 d/		28	30
1920's	11	38	51 b/		31 d/		26	36
1950's	8	30	41 b/	20 c/	35 d/	29 c/	25	19
1970's	11	38		29 c/	37 d/	36 c/	37	21

Sources: 1834-1929 for all countries; 1954-63 for the United States, 1957-63 for the United Kingdom, Italy, and France; 1950-56 for Japan; 1955-59 for Germany: Simon Kuznets, "Quantitative Aspects of the Economic Growth of Nations," Economic Development and Cultural Change, Vol. 15, No. 2, Part II (Jan. 1967), pp. 19,20;

a/ Years for which data were used for each country are: United States 1834-43, 1804-13, 1918-28, 1954-63, 1970-74; United Kingdom 1837-45, 1809-13, 1924-28, 1957-63, 1970-74; France 1845-54, 1805-13, 1920-24, 1957-63 and 1954-63, 1970-74; Germany 1872-79, 1919-13, 1925-29, 1955-59 and 1954-63, 1970-74; Italy 1861-70, 1911-13, 1925-29, 1957-63, 1970-74; Japan 1878-87, 1908-13, 1918-27, 1950-56, 1970-74.

b/ Exports plus imports as a percentage of value added in agriculture and manufacturing (including mining and handicraft and some construction).

c/ Exports plus imports as a percentage of GNP.

d/ Exports plus imports as a percentage of the sums of private and government consumption and net domestic capital formation.

Table 4

US Export and Import Trade Relative To US GNP, 1951-78

Year	Exports/GNP	Imports/GNP
1951	0.04	0.04
1955	0.04	0.03
1960	0.04	0.03
1965	0.04	0.03
1970	0.04	0.04
1975	0.07	0.07
1978	0.07	0.09

Source: IMF, *International Financial Statistics*.

Table 5

UNITED STATES IMPORTS FROM MAJOR COUNTRY GROUPS AS A PERCENTAGE OF THEIR TOTAL EXPORTS

Year	Exporter				
	Western Europe	Japan	Developing Countries		
			All	Oil Producers	Other
1952	7	19	26	NA	NA
1955	7	23	23	NA	NA
1960	8	27	22	NA	NA
1965	8	30	19	NA	NA
1970	8	32	21	26	10
1975	6	22	22	26	17
1977	7	25	26	27	25

Table 6:

U.S. Balance of Payments Statistics
(Millions of U.S. $)

	1946	1950	1955	1960	1965	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977
Merchandise Trade Balance1/2/	5208	1005	2753	4736	4951	635	607	2603	-2260	-6418	873	-5365	• 8935	-9371	-31070
Current Account Balance3/	7349	1605	2250	4544	7818	1587	2592	4703	1333	-3030	9688	8103	22349	8713	-11057
Government Transfers	-2267	-3472	-1901	-1937	-2271	-2243	-2186	-2346	-2739	2942	-2850	-6409	-3965	-4400	-4160
Long-term Capital Account Balance4/	3763	-578	-881	-3150*	-7343*	-2828*	-4349	-6346	-9079	-5635	-6744	-8283	-19281	-14329	-12487
Basic Balance5/	8845	-2445	-532	-543	-1796	-1584	-3943	-3989	-10485	11607	94	-6589	-897	-10016	-27704
Short-term Capital Account Balance6/	1006	702	491	-2423	508	3252	6682	-6718	-19990	525	-2554	-2235	-3537	-527	-7405
Balance of Payments7/	9851	-1743	-41	-2996*	-1288*	1668*	2739	-10707	-30475	-11082	-2460	-8824	-4434	-10543	-35109

Source: **Balance of Payments Yearbook, IMF.** "Standard Presentation" (except where noted), various volumes

* derived from both "Standard Presentation" and "Analytic Presentation"
1/ 1946-1955, F.A.S. basis; thereafter F.O.B. basis;
2/ Includes non-monetary gold
3/ Excludes government transfers
4/ Consists of government, private, and bank long-term capital
5/ Current Account, including government transfers and Long-Term Capital Account
6/ Short-term Capital Account consists of general government, private and bank short-term capital and Errors & Omissions
7/ Official Setttlements Basis - Basic Balance and Short-term Capital Account

Table 7:

Official Holdings of Reserve Assets, End of Years 1959, 65, 68, 69-77 and End of May 1978[1]
(In billions of SDRs)

	1959	1965	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	May 1978
Liquid reserves													
Fund-related assets													
Reserve positions in the Fund	3.2	$ 5.4	$ 6.5	$ 6.7	$ 7.7	$ 6.4	$ 6.3	$ 6.2	$ 8.8	$12.6	$17.7	$ 18.1	$ 17.2
Special drawing rights		–	–	–	3.1	5.9	8.7	8.8	8.9	8.8	8.7	8.1	8.5
Subtotal, Fund-related assets	3.2	5.4	6.5	6.7	10.8	12.3	15.0	15.0	17.7	21.4	26.4	26.2	25.1
Foreign exchange	16.[illegible]	23.8	31.9	32.3	45.4	75.1	96.2	102.0	126.9	137.5	160.6	201.2	206.6
Total liquid reserves	19.[illegible]	29.2	38.4	39.0	56.2	87.4	111.2	117.0	144.6	158.9	187.0	227.4	231.9
Gold													
Value (i) at SDR 35 per fine ounce	37.[illegible]	41.9	38.9	39.9	37.0	35.9	35.6	35.6	35.6	35.5	35.3	35.4	35.5
(ii) at London market prices	–		–	–	39.6	44.8	66.0	114.[illegible]	189.5	142.4	136.1	166.9	186.6

Source: International Financial Statistics.

1 "Fund-related assets" comprise reserve positions in the Fund and SDR holdings of all Fund members. Claims by Switzerland on the Fund are included in the line showing reserve positions in the Fund. The entries under "Foreign exchange" and "Gold" comprise official holdings of the Netherlands Antiles, Switzerland, and Fund members except Romania, for which data are not published. Foreign exchange holdings for 1973 include official French claims on the European Monetary Cooperation Fund.

ble 8: **Official Holdings of Foreign Exchange, by Type of Claim, End of Years 1970–77** [1]

(In billions of SDRs)

	1970	1971	1972	1973	1974	1975	1976	1977
Official claims on United States [2]	23.8	46.6	56.7	55.4	62.8	68.9	79.2	103.8
Official sterling claims on United Kingdom	5.7	7.3	8.1	6.5	8.3	6.4	3.2	3.3
Official deutsche mark claims on Fed. Rep. of Germany	1.3	1.0	1.4	2.2	2.4	2.5	4.3	5.7
Official French franc claims on France	0.6	0.8	1.0	1.2	1.1	1.1	0.9	0.8
Other official claims on countries denominated in the debtor's own currency	0.9	1.0	0.9	1.6	1.5	2.7	3.8	4.6
Official foreign exchange claims arising from swap credits and related assistance	0.7	—	—	0.4	1.6[3]	1.3[3]	1.5[3]	1.2[3]
Identified official holdings of Eurocurrencies								
Eurodollars								
Industrial countries	5.1	3.4	5.6	7.3	6.5	7.0	7.9	14.7
Primary producing countries								
More developed countries	1.6	1.7	3.2	3.4	3.0	3.8	3.7	4.8
Less developed countries	3.8	5.4	9.2	10.3	22.8	27.7	34.0	38.5
Western Hemisphere	*1.0*	*1.6*	*3.6*	*4.0*	*5.0*	*5.6*	*5.9*	*7.3*
Middle East	*0.6*	*1.1*	*1.9*	*2.3*	*12.0*	*16.7*	*19.1*	*20.6*
Asia	*1.1*	*1.1*	*2.0*	*2.7*	*3.0*	*3.5*	*5.9*	*7.8*
Africa	*1.1*	*1.6*	*1.7*	*1.3*	*2.8*	*2.0*	*3.1*	*2.9*
Memorandum item: Major oil exporting countries	1.6	2.8	3.9	4.0	15.6	20.7	23.7	25.8
Total identified Eurodollars	10.5	10.4	18.0	21.1	32.3	38.5	45.6	58.0
Other Eurocurrencies	0.4	1.1	3.2	5.3	5.8	7.2	7.6	12.3
Total identified holdings of Eurocurrencies	10.9	11.6	21.2	26.4	38.0	45.7	53.1	70.3
Identified claims on IBRD and IDA	0.7	0.6	0.6	0.6	0.9	1.8	2.5	2.1
Residual [4]	1.0	6.2	6.3	7.7	10.4	7.1	12.1	9.3
Total official holdings of foreign exchange	45.4	75.1	96.1	102.0	126.9	137.5	160.6	201.2

Sources: *International Financial Statistics* and Fund staff information and estimates.

[1] The official foreign exchange reserves covered in this table are described in Table 14, footnote 1. Includes the estimated change in the value of holdings owing to the general realignment of currencies in 1971, the U.S. dollar devaluation in 1973, and the widespread floating of currencies since 1974.

[2] Covers only claims of countries, including those denominated in the claimant's own currency.

[3] Comprises the double deposit arrangement between the Deutsche Bundesbank and the Bank of Italy.

[4] Part of this residual occurs because some member countries do not classify all the foreign exchange claims that they report to the Fund. It also includes asymmetries arising because data on U.S. and U.K. currency liabilities are more comprehensive than data on official foreign exchange as shown in *IFS*.

Table 9

CURRENCY BREAKDOWN OF OFFICIAL FOREIGN EXCHANGE RESERVES

(Dollar amounts in millions of U.S. dollars)

Dec. 31	Total 53 countries	U.S. dollars	Sterling	German marks	French francs	Other reserve currencies	Other assets
1970	$ 33,356	$ 27,113	$2,988	$ 710	$ 8	$ 1,800	$ 737
	(100.0)	(81.3)	(9.0)	(2.1)	(.0)	(5.4)	(2.2)
1971	62,116	48,194	4,936	1,917	109	3,951	3,009
	(100.0)	(77.6)	(7.9)	(3.1)	(.2)	(6.4)	(4.8)
1972	76,392	61,879	5,074	3,628	293	5,048	469
	(100.0)	(81.0)	(6.6)	(4.8)	(.4)	(6.6)	(.6)
1973	88,866	70,864	4,409	5,870	469	7,014	240
	(100.0)	(79.7)	(5.0)	(6.6)	(.5)	(7.9)	(.3)
1974	106,288	85,918	5,799	6,165	410	7,825	169
	(100.0)	(80.8)	(5.4)	(5.8)	(.4)	(7.4)	(.2)
1975	102,618	82,869	3,390	6,363	925	8,664	407
	(100.0)	(80.8)	(3.3)	(6.2)	(.9)	(8.4)	(.4)
1976	115,668	92,963	1,902	8,021	645	11,803	333
	(100.0)	(80.4)	(1.6)	(6.9)	(.6)	(10.2)	(.3)
1977	160,136	130,063	2,335	11,122	527	15,657	432
	(100.0)	(81.2)	(1.5)	(6.9)	(.3)	(9.8)	(.3)

1 Constant sample.
2 Consists mainly of U.S. Treasury securities issued to certain central banks in the late 1960's and denominated in the currency of the holder (Roosa bonds). However, it also includes small amounts of assets held by regional clearing unions, whatever their currency of denomination, and a small residual error due to reporting irregularities.
NOTE: Figures in parentheses indicate percentages of totals.
Details may not add to totals because of rounding.
SOURCE: International Monetary Fund.

FOR IMMEDIATE RELEASE May 8, 1979

The Treasury announced that there have been delays in mailing checks in payment of Treasury bills that matured on April 26 and May 3 and some slight delays are also expected in connection with the May 10 maturity. Treasury bill accounts maintained by commercial banks through the Federal Reserve Banks are not affected.

A combination of three circumstances contributed to the situation.

First, the historically high interest rates of recent months have resulted in a dramatic increase in participation by small investors in the Treasury's bill system. Tenders have increased by 379% and daily transactions by 427% since January 1978. This unprecedented volume has strained the facilities available for servicing the bill accounts. The problem is complicated by the fact that more than half of the accounts maintained by Treasury are rolled over at maturity into new issues, at the investors' option, but in most cases these investors do not submit their reinvestment requests until the last minute.

Second, in the month of April, the postponement of auctions because of the failure of the Congress to act in timely fashion on the debt ceiling legislation made it necessary to compress five bill auctions into an exceptionally short period. The abnormal workload created by this congestion caused delays in the issue of checks.

Third, in late April there was an unanticipated failure of word-processing equipment used to prepare check schedules.

The situation has been corrected and checks for the May 17 bill maturities are expected to be mailed on schedule.

The Treasury is considering whether any action can be taken to adjust the matter of interest on the delayed payments.

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partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
Thursday, July 19, 1979

CONTACT: Alvin Hattal
202/566-8381

TREASURY ANNOUNCES TERMINATION OF ANTIDUMPING INVESTIGATION CONCERNING FRESH WINTER VEGETABLES FROM MEXICO

The Treasury Department announced today that it is terminating its investigation under the Antidumping Act of imports of five types of fresh winter vegetables from Mexico.

The investigation was terminated because the petitioners who had invoked the Act -- three groups of vegetable growers in the State of Florida -- withdrew their complaint. In withdrawing the complaint, counsel for the Florida industry stated that the petitioners wished to provide the Government with an opportunity to negotiate arrangements to avoid market disrupting imports of produce. Such negotiations are being planned for August.

Secretary of the Treasury W. Michael Blumenthal stated that he very much welcomed the withdrawal of the petition. He said, "It should improve the climate for the talks that will hopefully provide us with a constructive solution to a problem that is difficult to deal with under the Antidumping Act." He noted, however, that the language of the Act does not exclude agricultural products and that it had been applied in the last decade to grapes from Canada and eggs from Mexico and Canada.

The withdrawal is "without prejudice." Thus petitioners have reserved the right to refile their petition at a later date. If refiled, Treasury's General Counsel, Robert H. Mundheim, has agreed to give the petition expedited consideration in reaching a Tentative Determination.

The proceeding involved tomatoes, peppers, cucumbers, squash and eggplant, grown primarily in Culiacan, Mexico, and marketed in the United States from November through April. Imports of such products are valued at about $200 million annually, of which roughly 60 percent is accounted for by tomatoes.

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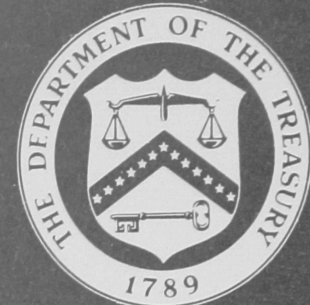
B-1736

Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041



FOR RELEASE ON DELIVERY
Expected at 2:00 p.m.
July 20, 1979

STATEMENT OF PAUL H. TAYLOR
FISCAL ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON
ENVIRONMENT AND PUBLIC WORKS

Mr. Chairman and Members of the Committee:

I am glad to be here this morning to discuss the Treasury Department's role under section 9 of the John F. Kennedy Center Act.

That provision authorized the Center's Board of Trustees to issue revenue bonds to the Secretary of the Treasury in an amount not to exceed $20.4 million. The proceeds were to be used to finance the Center's parking facilities, the bonds were to be repaid from revenues accruing to the Center, and interest on the indebtedness was to reflect the cost of market borrowings by the Treasury. The Act permits deferral of payment of the interest with the approval of the Secretary of the Treasury, but stipulates that interest so deferred will

bear interest after June 30, 1972. Deferred interest does not, however, reduce the borrowing limitation. The first bond was issued on July 1, 1968 in the amount of $1.5 million and carried a maturity date of December 31, 2017. Attachment A to my statement shows the obligations, their interest rates and maturity dates.

The bonds provide that principal and interest are to be paid from parking revenues. However, because these revenues were insufficient to meet the current interest on the bonds (partially because a substantial portion was used to repay a $3.5 million loan from the parking concessioner), the Center's Board, in December 1968, and annually thereafter, requested and was granted a deferral of the interest by the Secretary of the Treasury. Attachment B shows the computation of deferred interest from December 31, 1968 through December 31, 1978. In February 1979 the Department granted a further one-year deferral after the Center indicated an intent to seek legislation to ameliorate their financial problems. In this connection, proposed legislation introduced in the 95th Congress would have provided for an accommodation between the Center and the Treasury whereby the Board would undertake to repay, in equal annual installments, the $20.4 million principal on the bonds and the Secretary would release the Board from its obligation to pay deferred and future interest

thereon. The proposed legislation was not considered, but we understand there is interest in the Congress to consider other measures to grant financial relief to the Center.

On December 20, 1977, the Comptroller General transmitted to the Secretary of the Treasury a report on the financial operations of the Center. The report pointed out that one of the Center's largest financial obligations is the $15 million in interest and deferred interest owed to the Treasury on the revenue bonds. The report concluded that only the Congress can determine the "future financial course" of the John F. Kennedy Center for the Performing Arts. We concur in that assessment, recognizing that that determination will require an accommodation between the Center and the Treasury. We believe the Center's status as a national memorial and cultural center requires us to view their financial impairment in a different light than would be the case with respect to normal business-type operations of the Government. Therefore, the Department would support the write-off of the Center's interest obligation to the Treasury. We also believe that a firm schedule for repayment of the principal should be adopted, and in that connection we suggest that the Treasury advance to the Center the necessary funds to pay off the remaining balance on the concessionaire loan so the the major portion

of parking revenues can be dedicated to repayment of the bonds. We also suggest, as a practical matter, that the Secretary of the Treasury be appointed to the Center's Board of Trustees since the Department has a substantial financial interest in the Center.

That concludes my prepared statement, Mr. Chairman. I will be glad to respond to any questions.

Attachments

oOo

Attachment A

John F. Kennedy Center for the Performing Arts
Loans, John F. Kennedy Center, Parking Facilities
Revenue Bonds - 12/31/78

Rate	Bond No.	Due Date	Calendar Year Advanced	Accrued Face Amount	Interest to December 31, 1978 From	No. of Days To	Interest
5-1/8%	2-5	12/31/2017	1968	3,800,000	12/31/77	1 yr	194,750.00
5-1/4%	1-6	12/31/2017	1968	2,900,000	12/31/77	1 yr	152,250.00
5-3/8%	7 & 8	12/31/2017	1968	1,200,000	12/31/77	1 yr	64,500.00
5-3/4%	9 & 10	12/31/2018	1968	2,200,000	12/31/77	1 yr	126,500.00
5-7/8%	11 & 14	12/31/2018	1969	4,300,000	12/31/77	1 yr	252,625.00
6%	15	12/31/2018	1969	1,000,000	12/31/77	1 yr	60,000.00
6-1/4%	16 & 17	12/31/2018	1969	1,300,000	12/31/77	1 yr	81,250.00
6-1/2%	18 & 19	12/31/2018	1969	1,900,000	12/31/77	1 yr	123,500.00
6-5/8%	20	12/31/2018	1969	800,000	12/31/77	1 yr	
	21	12/31/2019	1970	1,000,000	12/31/77	1 yr	
				1,800,000			119,250.00
	GRAND TOTAL			20,400,000			1,174,625.00

John F. Kennedy - Deferred Interest
Revenue Bonds - 12/31/78

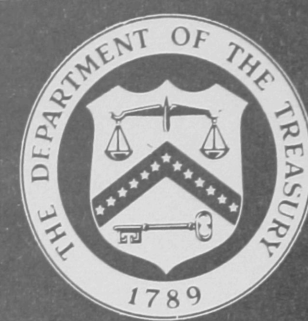
Year Deferred	Interest Deferred	Deferred Rate	Interest on Deferred Interest	Int. on Deferred Interest Deferred	Total Int. Deferred
12/31/68	114,176.57	5-1/2%	6,279.71		
12/31/69	775,852.06	7-1/8%	55,279.46		
12/31/70	1,152,844.18	6-5/8%	76,375.93		
12/31/71	1,174,625.00	5-7/8%	69,009.22		
12/31/72	1,174,625.00	6-1/8%	71,945.78		
12/31/73	1,174,625.00	6-7/8%	80,755.47		
12/31/74	1,174,625.00	7-3/4%	91,033.43		
12/31/75	1,174,625.00	7-1/2%	88,096.88		
12/31/76	1,174,625.00	6-1/8%	71,945.78		
12/31/77	1,174,625.00	7%	82,223.75		
	10,265,247.81		692,945.41		
Interest on Deferred Interest Deferred 12/31/72		6-1/8%	103,472.16	6,337.66	
" " " " " 12/31/73		6-7/8%	285,227.76	19,609.41	
" " " " " 12/31/74		7-3/4%	385,592.64	29,883.43	
" " " " " 12/31/75		7-1/2%	506,509.50	37,988.21	
" " " " " 12/31/76		6-1/8%	632,594.59	38,746.42	
" " " " " 12/31/77		7%	743,286.79	52,030.08	
			2,656,683.44	184,595.21	
					877,540.62

SUMMARY

Interest 12/31/78	1,174,625.00
Deferred Interest to date	10,265,247.81
Interest on Deferred Interest	3,349,628.85
Interest on Deferred Interest Deferred . . .	184,595.21
	14,974,096.87
Principal owed	20,400,000.00
Total Interest owed	14,974,096.87
Total owed 12/31/78	35,374,096.87

Attachment B

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



FOR RELEASE UPON DELIVERY
Expected at 9:30 a.m.
July 20, 1979

STATEMENT OF DANIEL I. HALPERIN
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR TAX POLICY
ON THE TAX TREATMENT OF FOREIGN CONVENTION EXPENSES
BEFORE THE
SUBCOMMITTEE ON TOURISM AND SUGAR
OF THE SENATE FINANCE COMMITTEE
JULY 20, 1979

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before this Subcommittee to discuss the deductibility of foreign convention expenses. After commenting on the three bills before the Subcommittee, I shall describe the Treasury's suggestion for change in this area. Of the three bills being considered, the Treasury Department opposes S. 589 and S. 749. If the Treasury proposal were to be adopted, S. 940 would be unnecessary; if the present system were to be retained, however, we suggest modifications to S. 940.

Present Law

Before I speak about legislative change, let me briefly review the law in this area.

A convention is deemed related to trade or business if, considering all the facts and circumstances, attendance at the convention benefits or advances the taxpayer's trade or business. If this test -- which is qualitative and not quantitative -- is met, then the cost of travel for the primary purpose of attending a convention is generally deductible regardless of the purely personal benefits a

taxpayer may derive from the convention trip. The Internal Revenue Code provision which allows a deduction for ordinary and necessary business expenses (section 162) denies a deduction only if the primary purpose of the trip is personal.*

Beginning in 1964, Congress imposed a further, although limited, restriction on the deductibility of expenses for foreign trips, including conventions (section 274(c)). If a foreign trip lasts longer than one week and at least twenty-five percent of the taxpayer's time on the trip is devoted to personal pursuits, only a portion of travel costs are deductible. The part allocated to personal activities, generally in proportion to the number of days spent on business or pleasure, is disallowed. But if the foreign trip lasts one week or less, or less than twenty-five percent of the time is spent on nonbusiness activities, the "primary purpose" test applies and expenses are deductible in full.

In 1976 Congress recognized the growing practice among professional, business and trade organizations to sponsor cruises, trips and conventions during which only a small portion of time was devoted to business activity. Committee reports noted that promotional material often highlighted the deductibility of expenses incurred in attending a foreign convention and, in some cases, described the meeting in such terms as a "tax-paid vacation" in a "glorious" location. Committee reports also noted that some organizations advertised that they would find a convention for the taxpayer to attend in any part of the world at any given time of the year.

In short, many taxpayers were attending foreign conventions primarily to take advantage of opportunities for sightseeing and recreation. However, since it was extremely difficult to distinguish between personal and business motives in taking such trips, taxpayers were able to claim a tax deduction. As a result, deductions for attending foreign conventions had become a source of tax abuse. In 1976, Congress responded to this problem with the provision under consideration today (section 274(h)).

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* Regardless of the primary purpose of the trip, the cost of meals and lodging at the convention site are deductible if they are attributable to a day spent on business.

Under this provision, deductions can be taken for no more than two conventions per year. For these two conventions, transportation expenses to and fro, not exceeding coach or economy air fare, are fully deductible if at least one-half of the days spent at the convention are business related; otherwise transportation expense is pro-rated. Subsistence expenses, limited to the Federal per diem for the particular location, are deductible for each day in which there are at least six hours of business activities if the taxpayer attends two-thirds of the scheduled activities. One half day of subsistence expenses is allowed if there are at least three hours of business activities and the taxpayer attended two-thirds of the activities.

These provisions are complex but at the same time continue to allow two deductible foreign vacations annually. We sympathize with the desire to mitigate recordkeeping and other burdens on legitimate business activities. But this does not require that we jettison any restrictions on foreign conventions. Rather, it is possible to mitigate the burdens on business while at the same time to deal more effectively with the abuse which led to the 1976 legislation.

We have a proposal to accomplish this goal. First, however, I shall comment on the three bills before the Subcommittee.

S. 589

S. 589 would exempt expenses incurred in attending conventions in Canada and Mexico from the limitations of section 274(h). There are several reasons why we oppose this legislation.

As we have stated, the purpose of the 1976 change is to prevent tax subsidized foreign vacations. Controlling abuse by attempting to determine the primary purpose of the trip on a case-by-case basis has proved ineffective to combat conventions promoted for their vacation features. S. 589 would apply the primary purpose test, which is known to have been subverted in the past, to conventions in Canada and Mexico. The issue is not whether American tourism in foreign countries should be encouraged or discouraged. The issue rather is whether American tourism in foreign countries should directly increase the tax burden of the average American taxpayer. From the point of view of the American

taxpayer who would, in the end, underwrite these Canadian or Mexican conventions facilitated by S. 589, a vacation that is taken in the guise of a convention in Canada or Mexico is not different than a vacation taken in any other foreign country.

Furthermore, the State Department consistently opposes legislation that discriminates among foreign countries. An additional point pertains specifically to conventions held in Canada. For some time now the Treasury Department has been involved in active negotiations with Canadian representatives with a view to modifying our existing income tax treaty, which dates from 1942. Most issues have been satisfactorily resolved, and there are only a few questions that remain, although these are admittedly quite important. Two of the remaining issues are the treatment of foreign conventions in Canada under United States tax laws; and the treatment of expenses for advertising on United States television stations under Canadian tax laws. We do not think it would be appropriate for the United States unilaterally to extend foreign convention benefits to Canada while negotiations are in process and the United States is seeking important tax concessions from Canada.

S. 749

S. 749 would repeal section 274(h) as enacted by the Tax Reform Act of 1976. We oppose S. 749.

As I have said, the provision was designed to curb tax deductions for foreign vacations. The law prior to 1976 created a serious enforcement problem for the Internal Revenue Service, and was perceived by many taxpayers as a tax loophole. To repeal section 274(h) and to substitute nothing in its place would be tantamount to approving the use of tax money to subsidize foreign vacations. However, we are not opposed to an overhaul of section 274(h), and I shall explain our suggestion shortly.

S. 940

A taxpayer who claims a deduction for foreign convention expense must attach to his return a written statement relating to attendance at the convention, which must be signed by an officer of the organization sponsoring the convention. (Section 274(h)(7)(B).) S. 940 would eliminate this requirement.

At present convention expenses are deductible only if the individual actually attends convention activities. We believe enforcement of this provision requires that the sponsoring organization verify attendence. On this basis, we oppose S. 940.

However, we would suggest two changes in the present rules which we believe will substantially reduce the compliance burden. First, the statement of the sponsoring organization must now be signed by an officer of the organization. The Internal Revenue Code uses the word "signed" literally; under the present wording of the statute, it is likely that signatory authority cannot be delegated and facsimile signatures cannot be used. To require an officer of any large sponsoring organization to sign personally hundreds or thousands of forms is too burdensome. We would support the elimination of the signature requirement.

Second, when an employer claims a deduction, the employer must attach to its return a statement from the sponsoring organization for each convention attended by each employee, as well as written statements signed by the employees themselves. In the case of an employer with a large number of employees, this requirement makes the employer's tax return unwieldly, to say the least. We would support a proposal that would allow employers with large numbers of employees attending foreign conventions to submit the information in summary form, such as a computer printout, with their returns, and keep the original statements in their own files to substantiate the deductions on audit.

Modifying both the signature requirement and the requirement of attachments to the return will lessen the compliance burden without weakening enforcement of the deductibility restrictions.

Treasury Proposal

In our view, the present provisions are inadequate to deal with the primary problem, namely, selection of the foreign site because of vacation motives without regard to business considerations. Even though a convention benefits a taxpayer's business to some degree, there is no justification for a tax deduction where the convention is held at a foreign site having notning to do with the taxpayer's business. In such cases the personal benefit predominates.

The mechanical tests of present law do not solve the problem. For those taxpayers with legitimate business concerns abroad, two conventions per year may well be too few. For those taxpayers with no international ties, two conventions per year are obviously two too many. Yet in both cases, present law allows deductions for the same number of conventions.

As a result, taxpayers who do business abroad and who commonly go to more than two foreign conventions or similar meetings per year have been faced with the strict disallowance rule. On the other hand, some taxpayers may still take two foreign vacations a year at public expense. Opportunities for such vacations are not hard to find. For example, the California Trial Lawyers Association sponsored seminars all over the world for its members in 1977. The promotional booklet advertises as follows:

> Decide where you would like to go this year: Rome. The Alps. The Holy Land. Paris and London. The Orient. Cruise the Rhine River or the Mediterranean. Visit the islands in the Caribbean. Delight in the art treasures in Florence.

The booklet also noted that these trips have been "designed to qualify under the 1976 Tax Reform Act as deductible foreign seminars." This type of advertising breeds disrespect for the tax system.

In order to solve this problem, we suggest a more objective test to determine whether attendance at a foreign convention is primarily for business purposes. The test is identical to that adopted by the Committee on Ways and Means in H.R. 9281, as reported to the House last year. It focuses on the reason why a foreign site is chosen for a convention. The expenses of attending a foreign convention, seminar or similar meeting would not be deductible unless it is more reasonable to hold the convention outside the United States and its possessions than within them. The factors to be considered in determining reasonableness of the convention site are: the purpose and activities of the convention; the purpose and activities of the sponsoring organization; the residence of active members of the sponsoring organization; and the places at which other meetings of the sponsoring organization have been held.

For example, if a significant portion of an organization's members resided in Canada, it could be considered more reasonable for the organization to hold a convention in Canada than in the United States. Similary, if the members of an organization composed of individuals engaged in a certain type of business regularly conducted a portion of their business in Mexico, it could be considered more reasonable for the organization to hold a convention in Mexico than in the United States.

The reasonableness test would supplement the primary business purpose test now used for business trips under present law. If it is not more reasonable to hold a foreign convention outside the United States and its possessions than within them, then all convention activities will be regarded as nonbusiness activities for which deductions would not be allowed.

If the foreign site meets the reasonableness test, the convention will be treated as a foreign trip, and must be related primarily to the taxpayer's trade or business. In addition, as with other business trips, the special restrictions on foreign travel will apply where the convention trip takes more than one week and at least one-quarter of the trip is spent on nonbusiness activities.

This approach, we feel, will go a long way toward distinguishing between true foreign vacations and bona fide business meetings that advance American business abroad. We regard this proposal as a complete substitute for the mechanical rules of present law. Accordingly, we propose to eliminate the annual maximum of two conventions and the recordkeeping and attendance rules.

Our proposal is aimed at the difficulty under present law in determining whether or not a foreign convention is primarily for a business purpose. Once the characterization of deductible business activities and nondeductible personal activities has been determined, the mechanics of allocating expense between those activities should be the same for conventions as for other foreign business trips. Accordingly, we do not suggest any special limits on the deductibility of convention transportation or subsistence expenses. If a convention passes the proposed foreign site test, it will be treated as a foreign trip. This approach will also tend to eliminate the troubling questions of whether a meeting is similar to a convention and which limits to apply when a trip has several phases, including attendance at a foreign convention.

Conclusion

I repeat that the evil to which the 1976 change was addressed was the tax subsidized foreign vacation that had no relation to on-going business ventures abroad. Our proposal meets this problem, while at the same time removing needless and burdensome restrictions on American business efforts in foreign countries.

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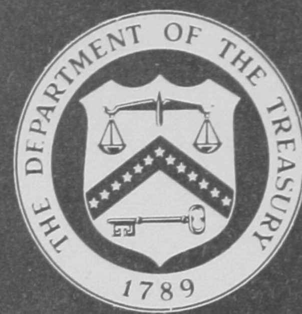

For Release Upon Delivery
Expected at 10:00 A.M.

STATEMENT OF
THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE
COMMITTEE ON WAYS AND MEANS
July 20, 1979

Mr. Chairman and members of this distinguished Committee:

On May 9, Secretary Blumenthal appeared before this Committee to review our severe energy problems and to discuss with you the President's program to address those problems.

The President's initial step in his effort to reduce our crippling reliance on imported crude oil was to direct the phasing out of price controls on domestic crude oil. This was begun on June 1. By October 1, 1981, all domestic oil will be decontrolled. This will end the subsidy to consume oil, thereby encouraging conservation, and will allow market forces to provide incentives for expansion of domestic oil production and for development of alternative energy sources.

The next step recommended by the President was 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 the windfall profits tax and increased income tax collections attributable to decontrol.

This Committee, under the Chairman's guidance, acted upon the Administration's proposal and produced a strong, well-balanced windfall profits tax. The House generally accepted the Committee's basic approach but did make a few significant changes. Although Secretary Blumenthal recommended to the Finance Committee that the House bill be modified in certain respects, the House has adopted a sound approach to the problem of windfall profits and has assured us of increased domestic production in the future as well as adequate revenues to finance the Energy Security Trust Fund.

B-1739

I would like briefly to update the energy situation as it has developed since Secretary Blumenthal testified before you in May. The events in that interim period dramatize in stark terms the need for us to act quickly to implement the President's proposals. Following this review, Principal Deputy Assistant Secretary Goldman of the Department of Energy will discuss the world oil problem as it relates to the President's program. W. Bowman Cutter, Executive Associate Director, Office of Management and Budget, will discuss the major elements of the President's program including allocations of trust fund monies. Assistant Secretary Lubick will deal with the tax proposals contained in the President's program as well as special tax provisions designed to discourage non-energy acquisitions by energy companies.

By the beginning of June, 1979, world oil prices (outside of the spot market) had reached an average of over $17 per barrel, an increase of more than 38 percent from December, 1978. The effects of the cutoff in Iranian production, gasoline shortages and rising prices for refined products, were rippling through the economy.

The June OPEC price increase strained our domestic energy situation further despite the moderation shown by some countries and despite Saudi Arabia's decision to increase temporarily its level of production. OPEC's price of $18.00 for Saudi marker crude was coupled with quality and location differentials of up to $5.50 and allowances for surcharges. We now calculate that these changes will translate into an average OPEC oil price of between $20 and $21, an increase of about 60 percent since December, 1978.

The oil price increases this year, when compared to the schedule announced by OPEC last December, increase the likelihood of a recession. The effect of increases made since December, 1978 will be to cut 1 percent from our growth rate in 1979 and another 1 percent in 1980. Thus, by the end of 1980 the level of GNP will be 2 percent below what would otherwise have occurred. The rate of inflation will rise by 1 percent in 1979 and another 1 percent in 1980 above what it would have been. Unemployment will increase

by 250,000 by the end of 1979 and another 550,000 by 1980, for a total of 800,000 beyond what it otherwise would be.

In March, 1979 we agreed 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. At the Tokyo Summit the President pressed for and won a more extensive commitment. In addition to limits on oil imports in 1979 and 1980, specific goals for each country were set for 1985. The U.S. goal for 1985 was to be 8.5 million barrels a day.

The President's Goal for 1990

Last Sunday, the President announced how we will achieve this goal. He pledged that this nation will never use more foreign oil than we did in 1977 -- 8.5 million barrels a day. He set as our goal cutting imported oil dependence by one-half by the end of the next decade -- a saving of over 4.5 million barrels per day. This means that an increasing portion of our energy needs must be met from our own production.

This is an ambitious goal. It will require sacrifice. It will be expensive. The windfall profits tax will be needed to pay for it. Without tax revenues the program cannot be financed without incurring serious deficits.

I will now turn to my associates to describe the details of the President's program.

For Release Upon Delivery
Expected at 10:00 a.m.
July 20, 1979

STATEMENT OF
THE HONORABLE DONALD C. LUBICK
ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE
COMMITTEE ON WAYS AND MEANS
July 20, 1979

Mr. Chairman and members of the Committee:

As part of the President's program to reduce dependence on imported oil, he has proposed a number of tax incentives to encourage development and use of alternative energy resources. As the Administration has indicated, these tax incentives should be funded by a charge to the Energy Trust Fund that is to be established under H. R. 3919.

Tax Credit Initiatives

The President has proposed major new tax solar initiatives as part of his program to generate 20 percent of the nation's energy requirements by the year 2000 by the use of solar energy. One element of his solar program is a Solar Bank. In additon to the Solar Bank, the President has proposed major new tax credits for solar energy. These credits will provide a significant stimulus for the use of solar energy and reduce our reliance on imported oil for heating and transportation.

In addition to the solar energy credits, production credits for gasohol and the development of oil shale and unconventional natural gas are proposed.

Tax Credit for Passive Solar Residential Construction

Current decisions regarding energy efficiency in the design of new buildings will affect energy demands for decades. These credits will provide incentives to builders to design and build structures which are estimated to save energy at a level significantly above the Federal Building Energy Performance Standard (BEPS) and therefore conserve our energy for many years to come.

Builders of residences with up to four family units would be eligible for a passive solar tax credit. Prior to January 1, 1983, 20 percent of the cost of passive solar property (meeting specified standards), up to a maximum of $2,000 per unit would be allowed as a credit. After December 31, 1982, and through December 31, 1985, the full $2,000 credit would be available to builders of new residences if the unit requires 50 percent or less energy than specified in the Federal Building Energy Performance Standards (BEPS). The Department of Energy will promulgate BEPS for residential construction prior to January 1, 1983. These standards will be established on a regional basis, and states will be requested to conform housing codes to BEPS.

Treasury will issue regulations setting out the procedures under which a design must be certified as meeting or exceeding the standard for the credit. If a state housing code conforms to BEPS, a certification by an architect, engineer or other person designated by the state that the design qualifies will suffice. If the state housing code does not conform to BEPS, the Treasury regulations will specify a method of certification.

Tax Credit for Commercial Passive Solar Construction

In the interest of long-range conservation builders of commercial structures will be provided with a tax credit of $20 per million Btu estimated design savings per annum for thermal performance at a specified level above the baseline, up to a maximum of $10,000 per building.

The Department of Energy will, pursuant to the Energy Conservation and Production Act, promulgate BEPS, which will be expressed in terms of Btu's per square foot per year needed to heat and cool a structure and to provide hot water.

Tax Credit for Solar Process Heat

The generation of process heat for industrial and agricultural applications, a significant portion of which is provided by oil and natural gas, now accounts for about 25 percent of our energy demands. Use of solar to generate energy for process heat would significantly reduce our dependence on imports of foreign oil.

Under present law, a 10 percent refundable energy investment tax credit is available for solar property that is used to generate electricity or to heat or cool (or to provide hot water for) a structure. Solar equipment used in the production of process heat does not qualify.

Under the President's proposal, solar thermal energy property used to produce process heat would be eligible for an energy tax credit of 15 percent, effective through December 31, 1989.

Tax Credit for Woodburning Stoves

The nation's wood resources are very large and more than sufficient to allow a significant increase in the present use of wood for home heating. In order to encourage use of these resources, and reduce the amount of fossil fuel burned to heat homes, the cost of a high efficiency woodburning stove installed in a taxpayer's principal residence would be included in the definition of qualified expenditurre for purposes of the residential energy credit under section 44C of the Internal Revenue Code. Unlike other qualifying expenditures, however, a woodburning stove would qualify even if installed in a new residence.

All of the provisions of section 44C would be applicable, except that the woodburning stove credit would expire on December 31, 1982. The credit is equal to 15 percent of the cost of the stove, but not to exceed $2000, or a maximum credit of $300.

Excise Tax Exemption for Gasohol

In addition to these solar tax credits, the President also has proposed to make permanent the current exemption from the 4 cents per gallon federal excise tax on gasoline allowed any gasoline mixture with at least 10 percent alcohol. The exemption is scheduled to expire on October 1, 1984. Since enactment of the exemption in 1978, gasohol

sales have risen rapidly--from nearly zero a year ago to a rate exceeding 7 million gallons a year in February 1979. However only a few applications to build or expand commercial production facilities for gasohol are now pending. Permanent extension of the exemption could significantly increase the incentive for production of this fuel by providing the assurance of continued demand for the product that new investors need. We expect that economies of scale will help reduce the cost of producing gasohol in the future.

Shale Oil Tax Credit

Recoverable shale oil reserves in the Western United States have been estimated from 400 to 700 billion barrels; several times the size of Saudia Arabia's proven reserves. It is technically possible today to produce shale oil in large quantities. However it is not yet a financially viable proposition, although the expected cost of producing shale oil, $25 to $35 a barrel, indicates that it will be the first synthetic fuel to compete economically with imported oil.

In addition to including oil shale within the mandate of the Energy Security Corporation, the President has proposed a $3 tax credit for each barrel of shale oil produced. The credit would begin to phase out when the world oil price (or reference price) adjusted for inflation, reaches $22 a barrel and would terminate when the adjusted price exceeds $27.56 a barrel. It is expected that many companies need only the encouragement provided by this tax credit to begin the construction and operation of major oil shale production facilities. Oil shale projects receiving any assistance from the Energy Security Corporation would not be eligible for the oil shale tax credit.

A capital facility must be placed in service by December 31, 1993 for its production to be eligible for the tax credit. In addition, on-site access must be allowed to the facility for the purpose of environmental testing, to ensure that shale oil will be developed in an environmentally acceptable manner.

Because the credit is not taxable, the economic subsidy provided by the credit to corporations paying tax at the top corporate marginal rate of 46 percent is the equivalent of an additional $5.56 added to the sale price of shale oil. To reflect this fact the subsidy will be phased out as the adjusted price of oil exceeds $22, by reducing the subsidy by 54 percent of the amount by which the reference price exceeds $22.

Unconventional Natural Gas Tax Credit

Extremely large potential gas resources exist in the United States, in unconventional formations such as tight sands, Devonian shale, geopressured methane and coal seams. In addition to the mandate of the Energy Security Corporation to provide assistance for development of these resources and to initiatives to decontrol the price of this fuel, the President has proposed a tax credit for unconventional gas production. The tax credit will total $.50 per mcf of production. The tax credit will begin to phase out when the world oil price, adjusted for inflation, is equivalent to $28 per barrel and will phase out completely when the world price, adjusted for inflation, is $33.56 per barrel. As with the shale oil credit, the conventional gas producers receiving assistance from the Energy Security Corporation would not be eligible for the $.50 mcf tax credit.

Tax Provisions Designed to Discourage Nonenergy Acquisitions

The Committee has expressed an interest in exploring the use of tax provisions as a means of discouraging nonenergy related acquisitions by major oil companies. At least one bill, introduced by Mr. Gephardt (H.R. 4769), is before this Committee.

Mr. Gephardt's bill would impose an additional windfall profits tax on certain major oil producers that acquire, directly or indirectly, a significant interest in any corporation primarily engaged in an "unrelated" trade or business.

This proposal seems to arise from the following concerns. First, it is argued that the sheer size of certain oil companies and their apparent economic dominance call for measures to restrain their expansion beyond the energy sector. Second, these companies will have substantial increases in cash flow as a result of oil decontrol. Third, these companies will be unable or unwilling to invest increased oil revenues in energy development, and will seek to expand into nonenergy sectors.

With regard to the size of these companies and their dominance in the energy sector, existing anti-trust laws generally provide protection against anti-competitive practices. Two agencies, the Department of Justice and the

Federal Trade Commission, have the expertise to administer the anti-trust laws effectively. If the existing anti-trust laws do not adequately restrict oil companies from engaging in monopolistic practices, the Congress can amend these laws to achieve the desired policy.

The concern expressed that higher revenues from decontrol will provide oil companies with funds for acquisitions has already been appropriately addressed by this committee by approving a windfall profits tax on oil company revenues.

Thus, the objectives sought by Mr. Gephardt's bill and similar proposals may be more directly achieved. We would much prefer the direct approaches -- the windfall profits tax and the anti-trust laws -- to further complications of the tax laws.

Finally, the objective of ensuring oil company investments in energy-related activities may be directly realized through outright bans or other limitations. This direct route is taken by a bill recently introduced by Senators Kennedy and Metzenbaum. The Administration supports this approach.

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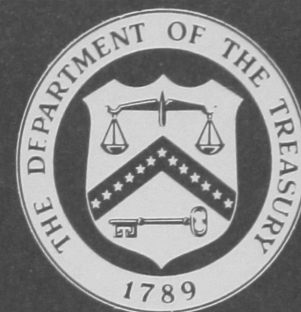


FOR IMMEDIATE RELEASE
EXPECTED AT 10:00 A.M., EDT
FRIDAY, JULY 20, 1979

STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
INFLATION TASK FORCE
BUDGET COMMITTEE
HOUSE OF REPRESENTATIVES

INFLATION AND THE EXTERNAL ECONOMIC POSITION OF THE UNITED STATES

THE ISSUE

It is now widely recognized that the United States has become part of an integrated world economy. One of every eight U.S. manufacturing jobs produces for the export market. One of every three acres of U.S. farm land produces to sell abroad. One of every three dollars of U.S. corporate profits derives from the international activities of U.S. firms. We depend on the rest of the world for oil and a wide range of other key raw materials.

There is less recognition, however, of the intimate relationship between external events and our domestic price level. To be sure, everyone understands the inflationary impact of OPEC price increases. This particular

problem must be countered by a wide range of initiatives in the energy area itself, as announced by the President earlier this week and already adopted during the past few years.

But the relationship between internal and external events has a much more pervasive impact on U.S. inflation. When U.S. inflation accelerates, relative to inflation in other countries, our international competitive position declines. Exports lag and imports rise, and our trade balance deteriorates. Every one percent increase in relative U.S. inflation produces a deterioration of about $2 billion in the U.S. trade balance. Sooner or later, the exchange rate of the dollar will weaken as a result.

This is only the beginning of the story, however. Such a weakening of the dollar raises the cost of our imports, and intensifies foreign demand for U.S. exports. Indeed, this is its purpose -- because both reactions, over time, will <u>if supported by proper domestic policies</u> improve the trade balance and restore our original competitive position.

In the short run, however, both effects of a weaker dollar add further to domestic inflationary pressures. Unless these are promptly and effectively contained by domestic economic policy, this additional inflation will produce a further weakening of the dollar which will produce more inflation, etc.

The result is what economists call the "vicious circle" -- an inflation/depreciation spiral which becomes increasingly critical to any country as that country becomes more deeply enmeshed in the world economy. For the United States, we estimate as a rule of thumb that every depreciation of one percentage point in the exchange rate of the dollar ultimately adds, directly and indirectly, 0.1-0.15 percentage points to U.S. inflation.

There is, of course, a "virtuous circle" diametrically opposed to the "vicious circle." Countries with low inflation rates experience an appreciation of their exchange rates. This in turn cheapens their imports and dampens demand for their exports. Both effects further reduce inflationary pressures in the country. This enhances their competitive position, lending to further appreciation of their exchange rates, etc.

Actual developments never fit economic theory perfectly, but one can readily identify particular countries with these stylized scenerios. Germany is the prototypical case of the "virtuous circle". Britain, before North Sea oil, was illustrative of the "vicious circle". Many other countries range toward one or the other end of the spectrum.

The Policy Implications

The policy lessons for the United States are clear:

-- there is an external, as well as a purely internal, reason to adopt and maintain an

effective fight against inflation because renewed weakness of the dollar will further compound domestic inflation;

-- it is essential to attack the external situation directly, to break into the "vicious circle" at that juncture as well as fighting its internal causes.

I will not address the internal policy aspect, except to reiterate the essentiality of maintaining the fight against inflation to a successful conclusion.

I will stress, however, the "purely domestic" merits of achieving and maintaining external balance and thereby braking inflation from the outside. The dollar defense program of last November 1 was motivated largely by just such a concern, and was eminently successful in strengthening and stabilizing the dollar. To achieve this goal on an ongoing basis, several steps are necessary:

-- a sharp reduction in the level of oil imports;

-- a sustained and effective commitment to increasing exports by both the U.S. Government and the private sector;

-- adequate economic growth, and openness to imports, in our major markets abroad.

The Administration has adopted, and is implementing, major policy steps in each of these areas. They are an essential component of the battle against domestic inflation. This link needs much greater recognition in the Congress and the American public, so that it will gain the support commensurate with the high stakes involved.

Recent Developments

Fortunately, we have achieved a number of recent successes in our effort to combat domestic inflation through external devices. The Multilateral Trade Negotiations (MTN) have been concluded successfully, enabling us to reduce our import barriers on a fully reciprocal basis with other countries. We have negotiated price-stabilizing commodity agreements for sugar and natural rubber, and are seeking to revise existing agreements for tin and cocoa, in ways that would contribute more to global price stability.

Most important, however, is the dramatic improvement in the U.S. trade and current account balance:

-- During the fourth quarter of 1977 and first quarter of 1978, our trade in goods and services (the current account) was in deficit at an annual rate of $24 billion;

-- During the second and third quarters of 1978, the deficit was cut in half to an annual rate of about $13 billion;

-- The deficit was nearly erased in the fourth quarter of 1978, and moved into surplus in the first quarter of this year.

For the full year 1979, we expect the current account deficit to fall to $4-5 billion from the $14 billion recorded in 1978. In 1980, we expect a small surplus. (A recent forecast to the contrary by the OECD, which failed to take into account the midyear revisions in our domestic economic outlook and the recent sharp rise in our earnings on services, is simply wrong.)

Looking at trade alone, our most recent projections -- made after the latest OPEC price increase -- suggest that the deficit will be reduced by about $6 billion during 1979 from last year's record $34 billion deficit. This improvement takes place at a time when our oil import bill will rise by an estimated $16 billion. Thus, the reduction represents an improvement in our trade balance -- excluding oil -- of something like $22 billion. That is an impressive gain.

Even more impressive, we believe our trade balance, excluding oil, will by the fourth quarter of 1979 have improved by $41 billion (annual rate) from its $5 billion (annual rate) deficit of the first quarter of 1978. In eight quarters, this represents a very substantial gain.

The gain comes from both sides of the trade account -- a marked slowing of the growth of imports and a quickening of exports. We estimate that import volumes -- excluding oil -- will fall some 2 percent between the first quarter of 1978 and the end of 1979. On the other hand, non-agricultural export volumes are projected to rise by 28 percent during the same period.

Both the spectacular growth of exports and the slowing of imports are largely the result of improvement in our competitive position over the past few years. Exports have risen particularly sharply over the past 12 months. During the March-May period, the volume of U.S. exports of non-agricultural products was roughly 15 percent higher than a year earlier. This strong growth in export volumes took place while world trade grew an estimated 5 percent. Clearly, U.S. products are gaining market share. On a volume basis, the U.S. share of world trade in 1978 rose to the highest level in three years and was higher than in 1971-72.

Conclusion

Recent events thus suggest that we could be on the path toward breaking the "vicious circle" of the recent past, which has plagued U.S. efforts to both check inflation at home and restore equilibrium abroad.

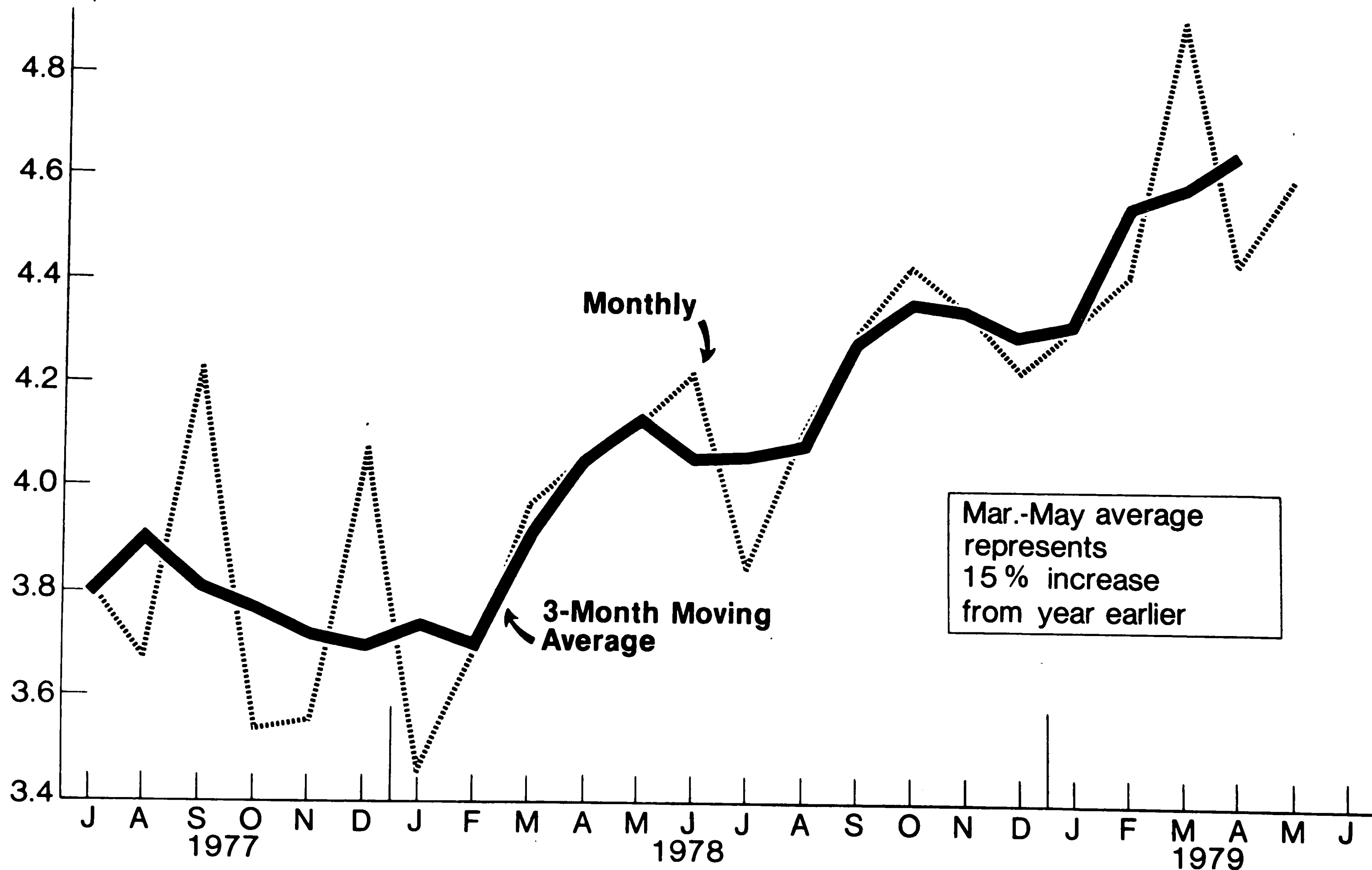
However, full achievement of such an outcome will require sustained attention to all of the policy efforts enumerated above: fighting inflation at home, defending the dollar abroad, cutting energy imports, expanding exports. Greater public awareness of the critical link between the external and internal issues is a necessary prerequisite for the Government to maintain such a focus. I applaud the efforts of this Task Force to help create such awareness.

Growth of U.S. Exports and Imports
(B/P-basis; % change, SAAR)

	79:Q1 from 78:Q1	March-May 1979 from year earlier
VOLUME:		
Non-Agricultural Exports	23	15
Agricultural Exports	4	- 6
Non-Petroleum Imports	1	2
Petroleum Imports	4	5
UNIT VALUE:		
Non-Agricultural Exports	13	13
Agricultural Exports	13	10
Non-Petroleum Imports	10	7
Petroleum Imports	5	17
VALUE:		
Non-Agricultural Exports	39	30
Agricultural Exports	17	4
Non-Petroleum Imports	12	9
Petroleum Imports	10	23

Treasury:Office of
Balance of Payments
7/19/79

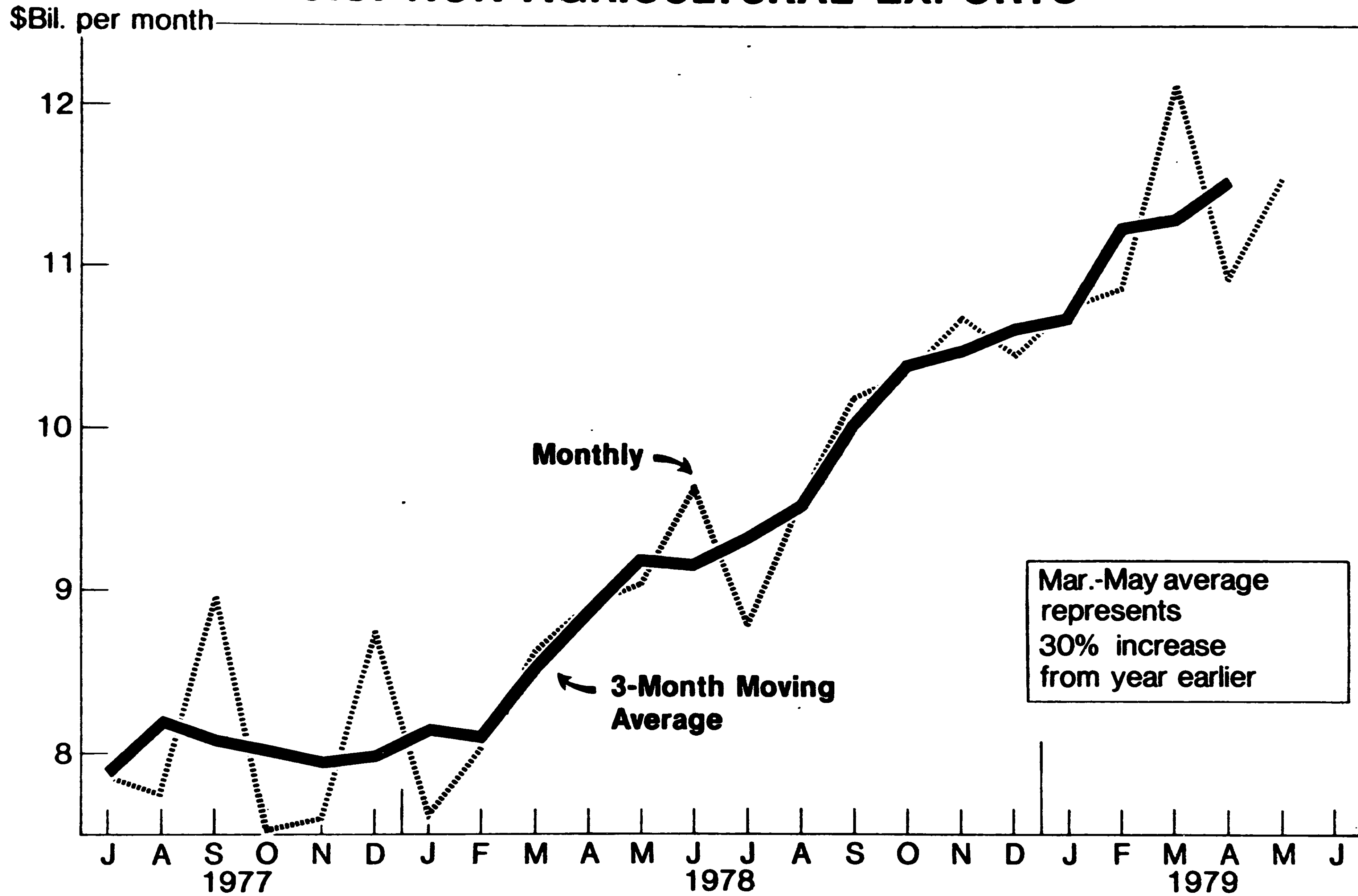
VOLUME OF U.S. NON-AGRICULTURAL EXPORTS*



*B/P basis, seasonally adjusted

Treasury: Office of
Balance of Payments
7/5/79

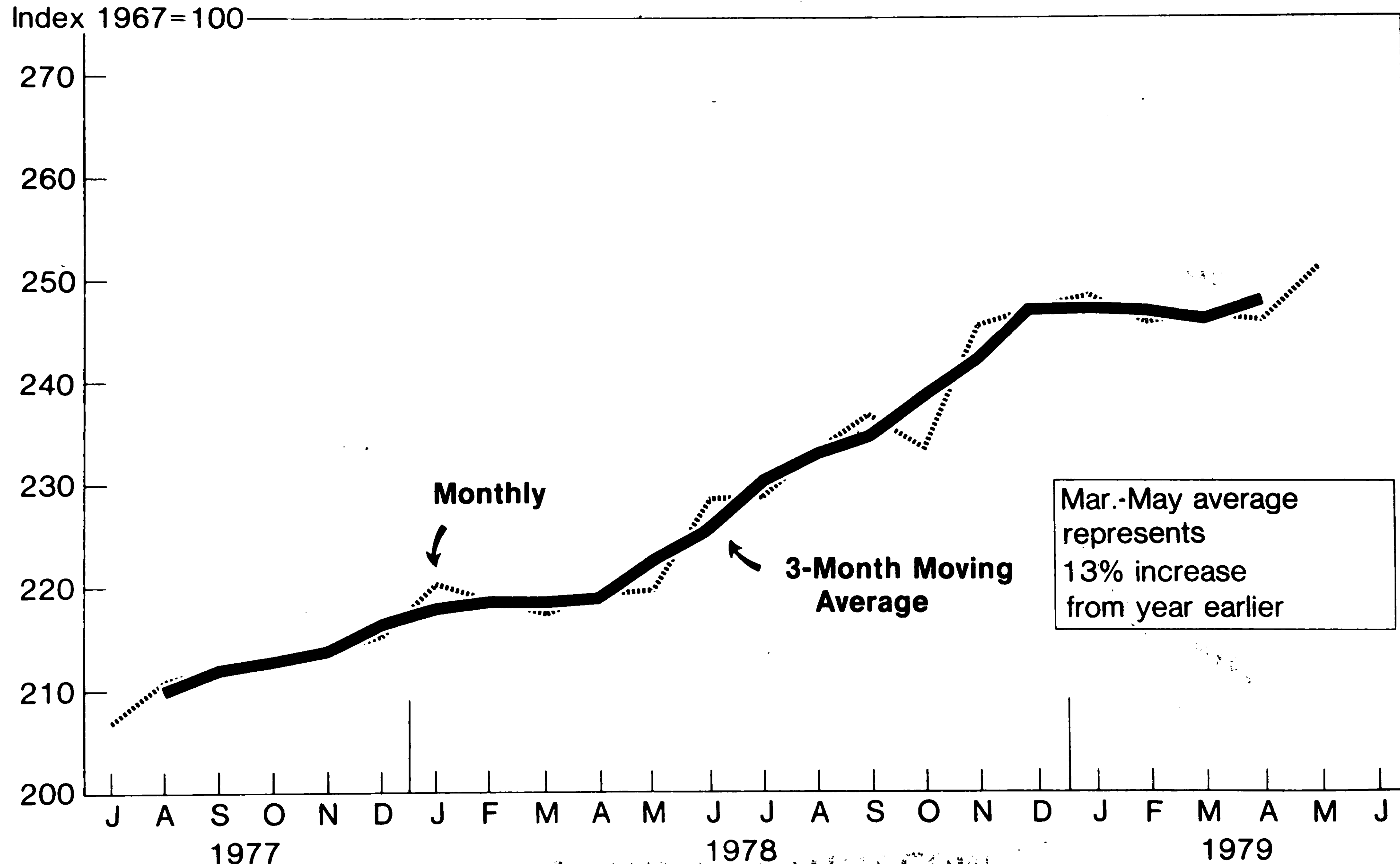
U.S. NON-AGRICULTURAL EXPORTS*



*B/P basis; seasonally adjusted

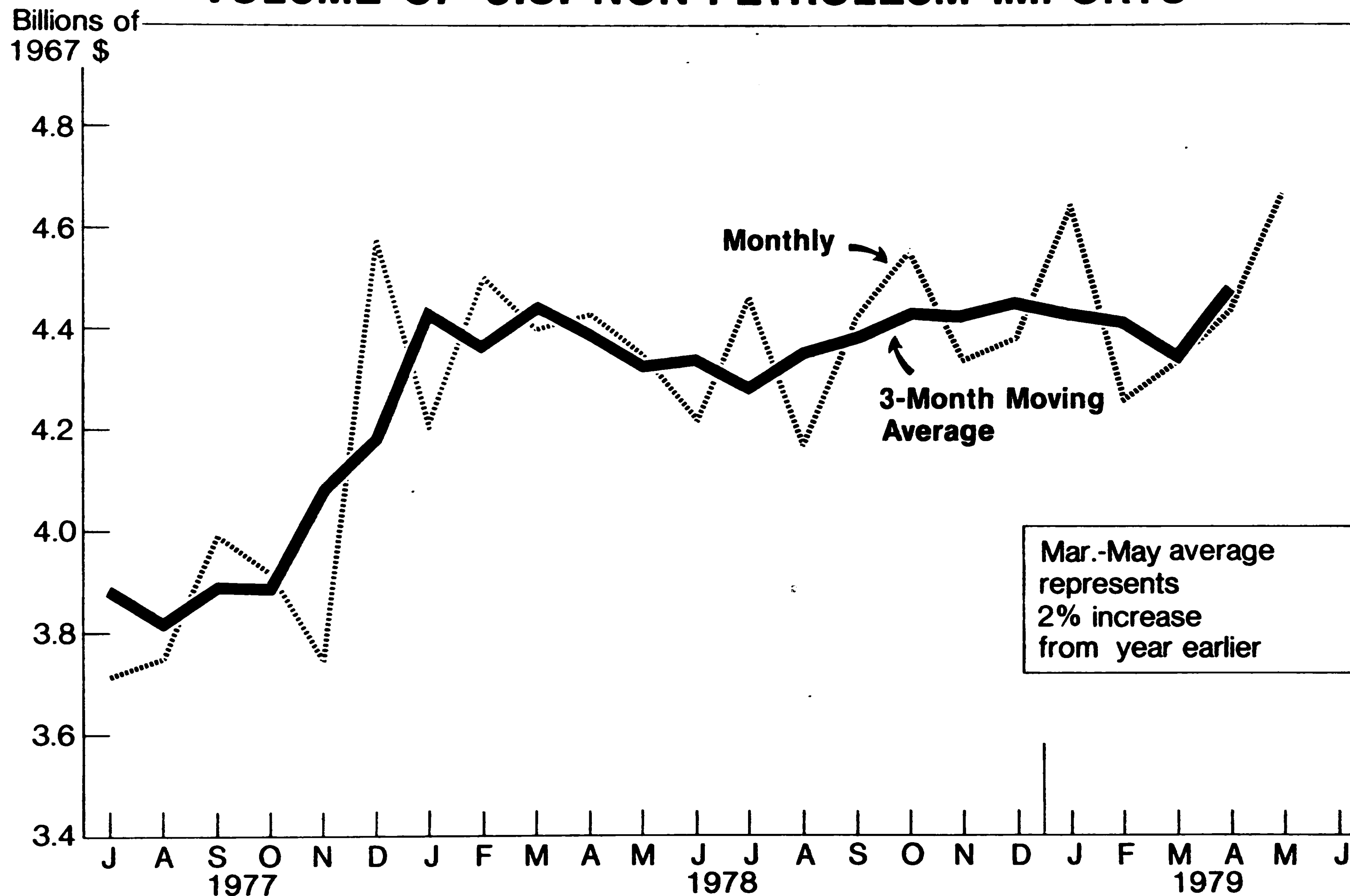
Treasury: Office of Balance of Payments
7/5/79

UNIT VALUE INDICES OF U.S. NON-AGRICULTURAL EXPORTS



Treasury: Office of Balance of Payments
7/5/79

VOLUME OF U.S. NON-PETROLEUM IMPORTS*



*B/P basis; seasonally adjusted

Treasury: Office of Balance of Payments
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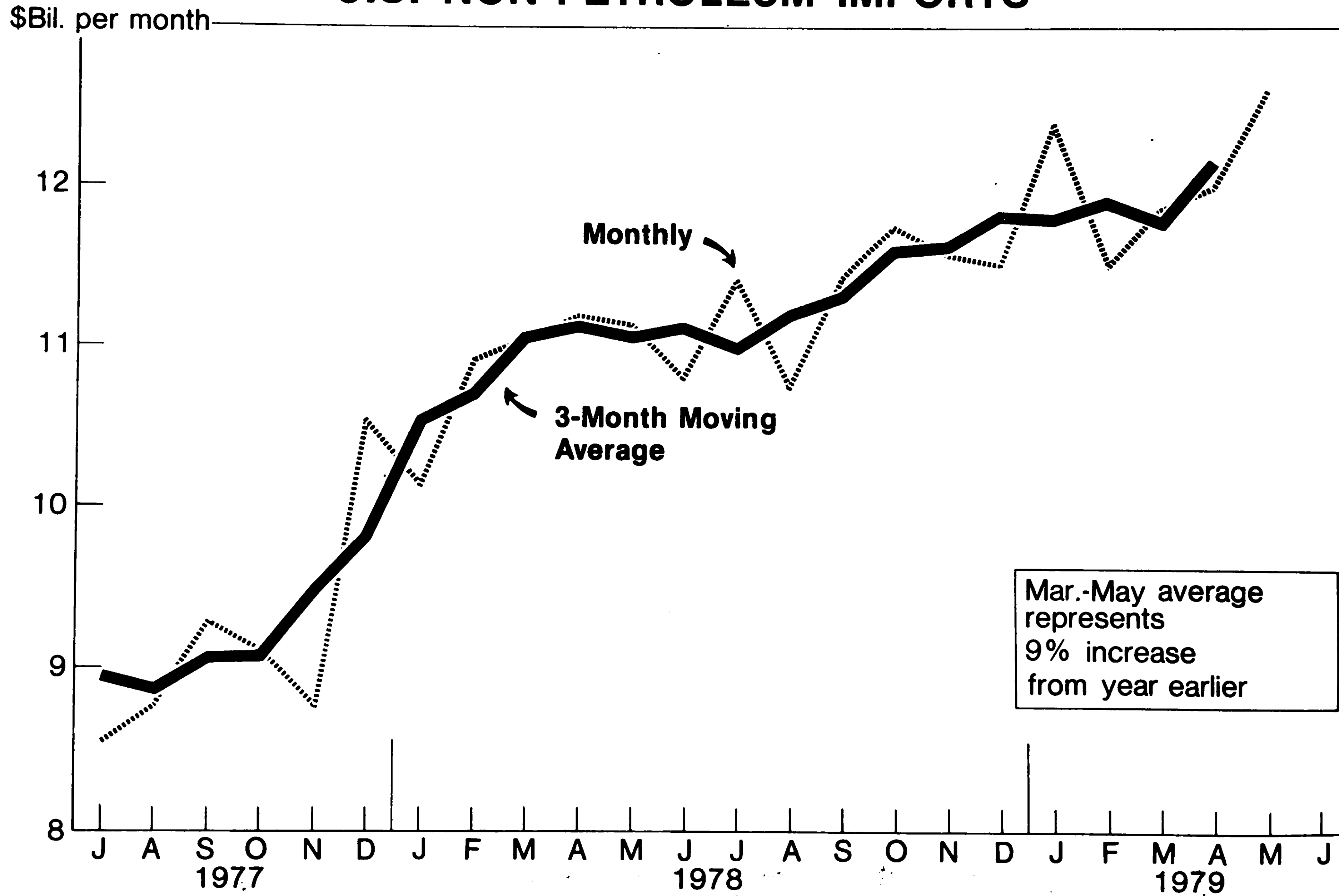
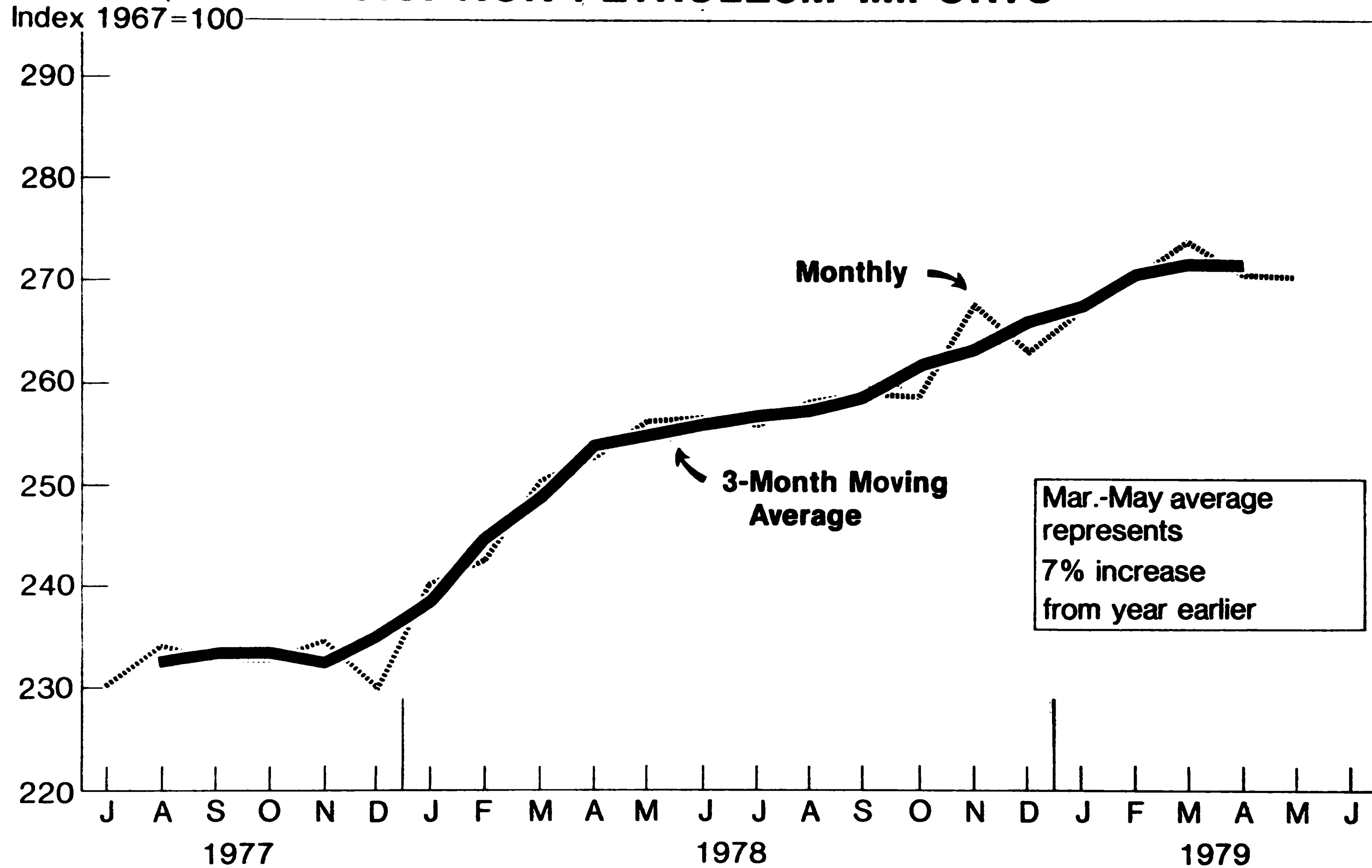
U.S. NON-PETROLEUM IMPORTS*



* B/P basis, seasonally adjusted

Treasury: Office of Balance of Payments
7/5/79

UNIT VALUE INDICES OF U.S. NON-PETROLEUM IMPORTS



Treasury: Office of
Balance of Payments
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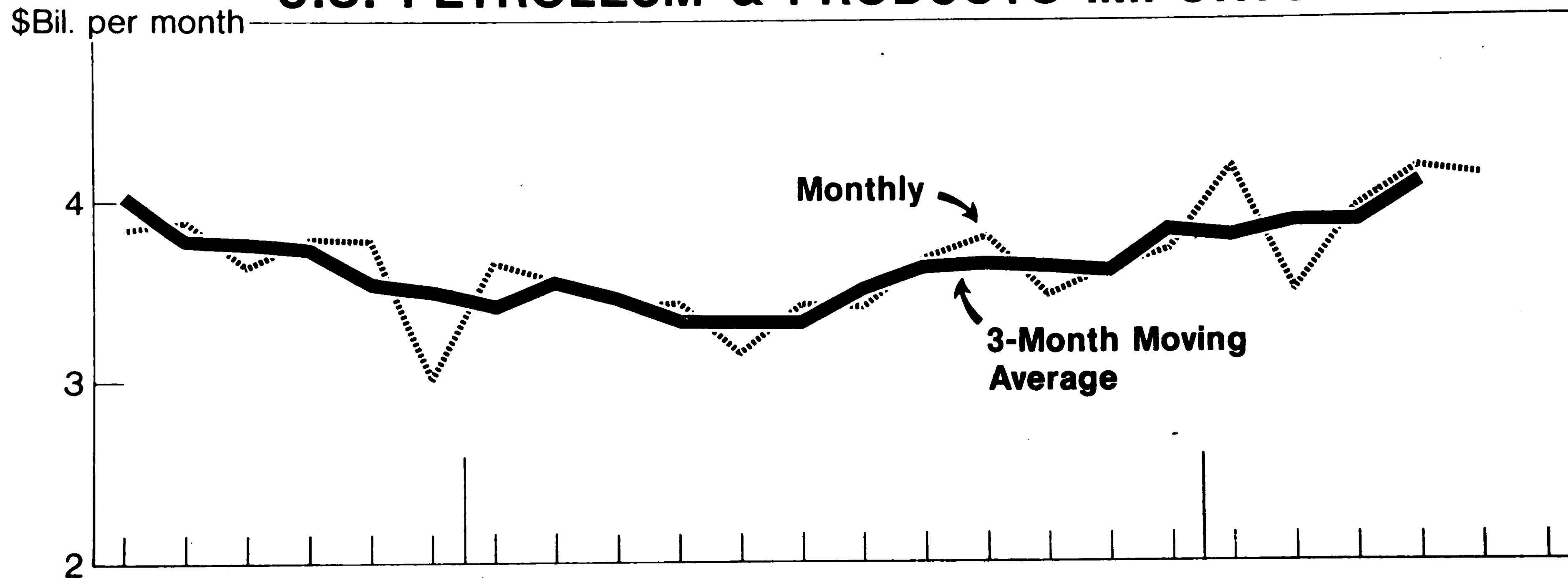
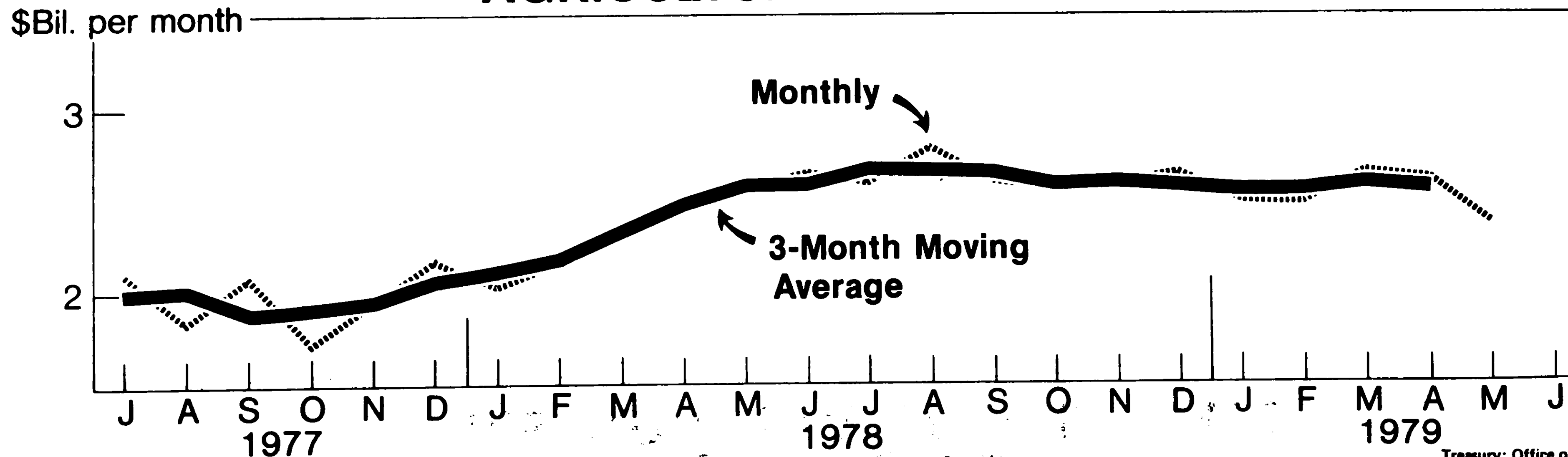
U.S. PETROLEUM & PRODUCTS IMPORTS*



AGRICULTURAL EXPORTS*



*B/P basis; seasonally adjusted

Treasury: Office of Balance of Payments 7/5/79

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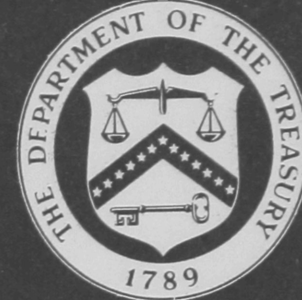

For Release at 10:00 am EDT July 20, 1979

Statement by Secretary Blumenthal

On behalf of the President, I strongly endorse the measure announced this morning by the Federal Reserve Board. It will be helpful in the fight against inflation, and in dealing with speculative pressures on the dollar.

The pressures on the dollar in the exchange markets that have emerged in recent weeks are completely at odds with the dramatic improvement in the U.S. balance of payments now underway -- an improvement that will reduce the current account deficit sharply this year and shift the position into surplus in 1980.

This country has serious energy and inflation problems. We are addressing these problems forcefully and comprehensively. Success will be critical to our nation's health. The United States will not permit a renewal of depreciation of the dollar to undermine its efforts. Massive resources are at our immediate disposal for market intervention, in cooperation with other major countries. We will not hesitate to use these resources, and enlarge them if necessary, to deal with unjustified pressures on the dollar in the exchange markets.

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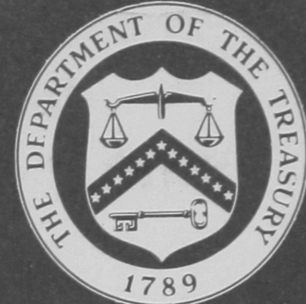

FOR IMMEDIATE RELEASE
July 20, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY STARTS COUNTERVAILING DUTY INVESTIGATION AND ISSUES PRELIMINARY FINDING THAT PAKISTAN IS SUBSIDIZING EXPORTS OF TEXTILE PRODUCTS TO THE UNITED STATES

The Treasury Department has started an investigation into whether imports of certain textiles and textile products from Pakistan are being subsidized. A preliminary determination that these products are being subsidized is being issued simultaneously. A final determination in the case must be made by January 20, 1980.

Imports of this merchandise amounted to about $42-million in 1978.

The products covered by this action were also involved in a recently completed investigation by the Treasury Department under the Countervailing Duty Law. In that investigation the Treasury determined that all Pakistani exports to the United States except cotton towels were being subsidized.

The new investigation is being started in order to determine whether Pakistani textiles are receiving additional subsidies under a program not considered under the original investigation.

The preliminary affirmative determination is based on Treasury's knowledge that the additional program was established specifically to benefit the Pakistani textile industry, and the fact that the benefits are paid only on exports. The investigation and preliminary determination apply to cotton towels as well as the other textile products previously investigated.

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 appears in today's Federal Register.

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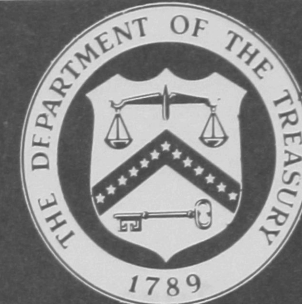

FOR RELEASE ON DELIVERY
Expected at Noon CDT

REMARKS BY
THE HONORABLE
W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
AT THE
NATIONAL URBAN LEAGUE
CHICAGO, ILLINOIS
JULY 23, 1979

This will likely be my last speech as Secretary of the Treasury. I can think of no audience that I would rather address on this occasion.

The Urban League represents the finest example of that peculiarly American blending of business expertise and social concern to which we owe so much of our nation's progress toward a more equitable and compassionate society. In leaving the public sector, I feel even more acutely than I did upon entering Government, that this very special American-style coalition of private resources and public concerns is vital to the nation's future -- and more urgently needed in the future than ever before.

In many parts of the world, it is taken for granted that the business elite will fight or frustrate, or at best ignore, all efforts to address the most crucial problems of social stagnation and economic injustice.

In America, while our record is hardly flawless, one can take for granted neither reactionary resistence nor sullen indifference on the part of our business communities. At critical moments in our history, the men and women of private business, or at least the best of them, have been essential allies in the struggle for social progress.

For this, all Americans owe an enormous debt of gratitude to this organization. For it is you, and others like you, who forge that vital link between the private sector and the public interest.

We owe an equal debt to the extraordinary man who has led your organization for so many years. Vernon Jordan has been a

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close personal friend for a long time. Lest that cause you concern, let me at once reassure you! I have it on good authority that this will not be held against him in Washington. His job, I presume, is quite secure!

I will not recite to you Vernon's personal virtues. For what is most important about Vernon is his singular public virtue. He is that rarest of figures in today's America. He is, through and through, and in every respect, a leader. The President was right in his address to the nation a week ago, when he noted that we have permitted too many of our social, economic, and political institutions to be corroded by doubt and indifference. This corrosion of basic social confidence no doubt has many causes. But there is, I expect, only one sure solution -- and that is to have come forward among us, in all walks of life, men and women with the public skill, the social conscience and the sense of responsibility that distinguish the career of Vernon Jordan.

Under his leadership, the Urban League acquired a valuable reputation for realism. You have learned the hardest of lessons: To solve problems, we must see things as they are. To make progress, we need more realism and less rhetoric. To improve our lot, we must see the world without illusions, as it really is, like it or not -- and however uncomfortable that may be for timid politicians and mindless poll watchers. In short, good policy is good politics -- is the courage to tell it like it is. Vernon, we all know, has had the guts always to do that - much to his credit and to that of the Urban League.

I would like today to take advantage of your willingness to face reality, to accept hard truths. I wish to share with you some of the major conclusions I have drawn, from my tenure as Secretary of the Treasury, about the relationship between economic policy and social progress in this country. These conclusions are, I'm afraid, rather hard-boiled, but they justify neither despair nor cynicism. They are, I think, merely the reality we must confront in trying to make this society more equitable and more compassionate.

My first conclusion is that meaningful social progress is nearly impossible in a high inflation economy. Inflation erodes compassion and altruism throughout society. It diverts us all into selfish, and often wasteful, efforts to "keep ahead of the game." Inflation makes people deaf both to the pleas of the poor and to the anger of those suffering discrimination and injustice.

Inflation, moreover, punishes worst precisely those very groups: the poor, the retired on small fixed incomes, those most dependent on enlightened policies to address their needs and ameliorate their unjust circumstance.

At the same time, high inflation inevitably drags down the rate of growth in real incomes, for it depresses investment and productive labor, diverting economic activity generally into unproductive channels. So long as inflation rages, there is virtually no prospect of a steady growth in real resources. And without a steady growth in real resources, there is virtually no prospect that a fair share will go to those most in need.

In our politics, an abhorrence of inflation is associated with conservatism. Liberals are assumed not to care much about the problem. To the extent those stereotypes are valid, liberals are misreading reality. For anyone who cares deeply about advancing the interests of our least advantaged citizens over the long haul, the priority item on the political agenda should be the fight against inflation. Until that fight is won, an inexorable tide will be running against the cause of social reform.

The common objection to an emphasis on inflation is that it implies an indifference to unemployment. Perhaps there was some validity to that association at another time. But to face the reality of the present, means accepting that this is no longer true. To face things as they are, means seeing that the simple inflation/unemployment tradeoff no longer holds. Economists and politicans don't really understand why, but they do know it to be true -- even though some of the political rhetoric still tells us otherwise.

In the mid-seventies, after all, we found ourselves with <u>both</u> high inflation <u>and</u> high unemployment. We even coined a new term for it: stagflation. And we learned that to lick one need not - indeed <u>cannot</u> - be done at the expense of the other.

If we keep revving up the budget deficit to fight each rise in unemployment, we will fail in our stated purpose: unemployment will go up despite our efforts -- and <u>inflation</u> will accelerate to astronomical levels. If, on the other hand, we stick to a steady course of fiscal and monetary prudence, any initial run-up in unemployment will be <u>lower</u> than in the first course -- and it will be coupled with true price stability.

This, at any rate, has been the experience of other nations, and it accords with the best work of our best economists, of all political persuasions. I, therefore, simply raise the question: Is it really liberal and compassionate to stave off a temporary economic slowdown at the certain cost of higher unemployment in the long term and at the devastating price of inflationary numbers which impoverish us all?

The second conclusion I wish to share with you is perhaps equally controversial. It is that economic equity rarely comes out of the barrel of a regulatory gun.

Economic regulation -- the control of prices and rates -- was the great political passion of many Americans for much of this century. The passion originated in a sensible perception that some markets are monopolized by a single producer. But the passion soon expanded well beyond its intellectual origins. Regulation became for many a handy, direct tool for assuring low prices. That is: regulation became a tool for distributing income. This led to the notion that it is somehow offensive to social justice for products to be sold in an unfettered market -- so-called "rationing by price" is considered illiberal.

Just as we are clearing away the awful consequences of such reasoning in the airline and trucking sectors of the economy, the regulatory passion threatens to stage a comeback in the energy sectors.

It is vital to the cause of social justice that we end this reliance on regulation. Regulation is a hopelessly cumbersome tool for distributing income from the rich to the poor; invariably, it ends up enriching those with the greatest access to the regulators or the greatest sophistication in manipulating the system. Regulation invaribly causes major economic inefficiencies -- resulting in higher prices over the long term and a totally unnecessary loss of real production and jobs. As a side effect, we find shortages and lines developing, which put new strains on the basic social fabric. Regulation becomes a new way to rip us apart and roughen the social temper. Perhaps most importantly, economic regulation diverts the efforts and talents of liberal politicians and public servants into building, staffing, and defending huge government bureaucracies that are doomed to failure and, ultimately, to public ridicule. Seeing government trying to do the impossible, the people are drawn to believe that government can do nothing.

Let me at once enter a caveat: I do not, of course, argue that any and all Government regulation impenging on the market place is invariably bad. Government does have a role to play. Monopolists do need to be curbed. Price gougers do need their wings clipped. Certain public goods do need to be regulated. The rules of the game to ensure fairness and equity and the protection of those with the least power, do need to be enforced.

But, for example, in dealing with our major national problem of energy, we cannot hope to insulate ourselves from the reality of the world market place. We must have programs to help the poor and the near-poor, with special forms of assistance. But, it is self-defeating to fool ourselves with regulating prices below what things really cost.

That is why the President's decision to decontrol the price of crude oil was the right decision. That is why decontrol of all oil products is inevitable sooner or later -- and the sooner the better. Our friends and allies in Europe have long since walked that road and we will have to do the same as soon as we have the courage to tell it like it is.

For those interested in social justice must choose their paths with care, for even then the journey will be long and hard. Those who choose the path of regulating prices are taking a dead-end. We need daring, not dead-ends.

My next conclusion is along the same lines. It is that we should throw overboard the simplistic notion that all federal spending for purposes of distributing income advances the cause of social justice. The sad fact is that many of the Government's programs for transferring money end up -- and quite by design -- in shifting it to groups distinguished not by their plight, but by their raw political power. The federal budget is too often bloated not by compassion for the poor but by a congenial coalition of middle or upper middle income groups that have learned to manipulate the Congress and the bureaucracy. The budget can be cut without setting back the disadvantaged, and it can be blown up without helping the poor.

Let me give you one small example. The President early this year suggested, and quite properly so, that some changes and--yes--some reductions in social security benefits were needed, so as to improve the financial integrity of the social security system and free up resources for more important social programs. The President wasn't talking about basic benefits. He wasn't suggesting cuts for those truly in need. He wanted merely to eliminate certain clear and obvious cases of double coverage and over-coverage in the system -- changes that would have

saved several billion dollars in the long term and that would have made the system both more rational and more equitable. The outcry of the defenders of the social security faith was as deafening as it was dead wrong. Nothing, they said, nothing in the system must ever be removed or reformed. This is blindness -- blindness which diverts resources where they are not needed in the name of protecting those long since protected in other ways. That is not social policy. That is foolishness.

The American people are neither wrong nor reactionary to demand budgetary integrity and restraint. The forces of social progress will do neither themselves nor their constituents any favors by defending federal spending in a general and uncriticial manner.

The harsh fact is that the productive sectors of the American economy cannot withstand in healthy fashion a steady expansion in the share of resources going through the Government as tax revenues and spending programs. Public resources are and will remain sharply limited. This means that programs aiding the poor cannot be expanded simply by piggy-backing them on top of the other special-interest, transfer programs that riddle the budget. In the past, that may have been a fruitful political technique -- productive of some amazing coalitions, progressive more in their rhetoric than their deeds -- but the technique is now running into hard economic barriers. The only route now open is the honest but risky course of justifying programs for the needy on their own terms, and joining aggressively in efforts to cut back spending where, in all good conscience, it is not needed. Whether this is politically possible, I do not know, but no other course is economically possible.

These then are the broad lessons I take from my recent stint in the Government: that social progress depends on reducing the rate of inflation, that this can be done in the long term without any permanent cost to jobs and production, that regulation is a dead-end way to work for economic justice, and that budgetary stringency is not in any logical sense incompatible with maintaining and improving programs to raise the prospects of the disadvantaged in this society.

I think of these convictions as economic realism wedded to social liberalism. That is the credo which I brought to the job of Treasury Secretary in January, 1977, and that philosophy has provided the framework formula of the Administration's economic and social policies over the past 2-1/2 years.

There is nothing quixotic about this marriage of economic logic and a social conscience. The only way to make real progress toward social justice is to confront the aspirations of the conscience with the realities of our economic situation.

This is no easy task in an era of severe economic constraints and of enormous problems on the energy front. In this era, you need a lot more than slogans and righteousness to make social progress. I took it as my job, while in the Government, to fight hard and with candor for economic sanity, and I am proud of it. I will let history judge whether I have reason to be.

At the same time, I supported, whenever I could,sound policies to advance social justice -- policies to help rebuild our cities, to retrain our workers, to employ our young, to cushion the impact on the poor of the economic turbulence of our times.

As the President pursues this general line of policy -- sound, realistic, and conservative in economics, compassionate, daring, and imaginative in social policy -- he will have my full support.

This is not just the Government's job. If we are to make real progress against the high ostacles thrown up by inflation and the energy crisis, the private sector will have to assume a very large part of the leadership role. That is your job. And, I assure you, I now also regard it as mine. Let's get on with it.

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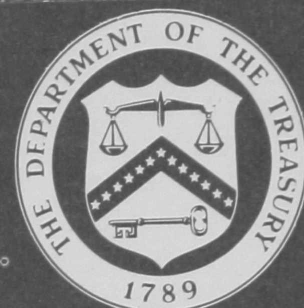

FOR IMMEDIATE RELEASE July 23, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,001 million of 13-week bills and for $3,003 million of 26-week bills, both to be issued on July 26, 1979, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 25, 1979			:	26-week bills maturing January 24, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	97.608 a/	9.463%	9.86%	:	95.217	9.461%	10.10%
Low	97.600	9.495%	9.89%	:	95.208	9.479%	10.12%
Average	97.604	9.479%	9.87%	:	95.211	9.473%	10.12%

a/ Excepting 1 tender of $800,000

Tenders at the low price for the 13-week bills were allotted 56%.
Tenders at the low price for the 26-week bills were allotted 80%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 42,655	$ 42,655	:	$ 33,590	$ 26,590
New York	4,160,500	2,548,570	:	4,777,060	2,627,840
Philadelphia	25,610	25,610	:	36,515	36,515
Cleveland	36,830	36,830	:	47,355	27,070
Richmond	30,350	30,150	:	25,115	25,115
Atlanta	48,615	48,615	:	33,345	27,345
Chicago	215,415	67,940	:	286,700	35,700
St. Louis	37,505	18,505	:	41,470	18,470
Minneapolis	5,585	5,585	:	5,165	5,165
Kansas City	39,320	31,910	:	26,410	23,535
Dallas	19,895	18,895	:	27,355	11,355
San Francisco	223,440	91,240	:	300,375	101,375
Treasury	34,145	34,145	:	36,935	36,935
TOTALS	$4,919,865	$3,000,650	:	$5,677,390	$3,003,010
Type					
Competitive	$3,002,115	$1,082,900	:	$4,108,415	$1,434,035
Noncompetitive	543,860	543,860	:	389,775	389,775
Subtotal, Public	$3,545,975	$1,626,760	:	$4,498,190	$1,823,810
Federal Reserve and Foreign Official Institutions	$1,373,890	$1,373,890	:	$1,179,200	$1,179,200
TOTALS	$4,919,865	$3,000,650	:	$5,677,390	$3,003,010

1/Equivalent coupon-issue yield.

B-1744

DATE: July 23, 1979

	13-WEEK	26-WEEK
TODAY:	9.479%	9.473%
LAST WEEK:	9.336%	9.255%

HIGHEST SINCE:

6-4-79	9.554%	
5/21/79		9.602

LOWEST SINCE:

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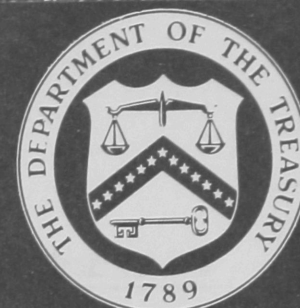

FOR RELEASE UPON DELIVERY
EXPECTED AT 10:00 a.m.
July 24, 1979

STATEMENT OF
EMIL M. SUNLEY
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
BEFORE THE
TASK FORCE ON INFLATION OF THE
HOUSE BUDGET COMMITTEE

Mr. Chairman and Members of this distinguished Committee:

I appreciate this opportunity to appear before you and discuss the subject of Indexation of the Tax System. In recent years there has been a great deal of interest in indexation or automatic inflation adjustment of the tax system and I think the reason for this interest is clear: The high rates of inflation we have experienced in recent years have made it obvious to everyone that our tax system is not "neutral" with respect to inflation, but rather the system tends to increase effective tax rates as inflation proceeds. This has always been true of our tax system, but has never been considered a problem in the past.

If inflation were proceeding at an annual rate of only one or two percent as it did in the early 1960's, I am sure there would be much less interest in a tax change as complicated as that implied by indexation. On the other hand, if the rate of inflation were to accelerate and reach a level of 20 or 25 percent as in some other countries, probably most people would favor some form of indexation. Thus, one factor in deciding whether we wish to index the tax system is our expectation concerning likely future inflation rates. If we expect a moderate rate of inflation--say six or seven percent--we must then decide whether the complexities involved in going to an automatically indexed system are worth the gains or whether there are other forms of ad hoc adjustments involving much less tax complexity which could achieve the same ends.

There are two quite separate issues involved in indexing the tax system, and I would like to discuss them separately. They are the definition of income and the proper tax treatment of income, once defined. I will begin by discussing the second issue, the tax treatment of nominal dollar amounts, because in this area proposals and recommendations have been most fully developed.

Fixed Dollar Amounts

As inflation occurs, the real value of fixed dollar amounts declines. Since income taxes are computed from tax brackets and exemptions that are defined in fixed dollars, tax liabilities and effective tax rates rise. To illustrate this result, consider a family consisting of a husband, wife, and two children with an income of $20,000. Their income tax this year would be $1,908 or about 9.5 percent of income assuming they did not itemize deductions. Now let's assume that inflation runs at an annual rate of seven percent and that this family's income increases next year by this same percentage. Then their dollar income in 1980 would be $21,400, while their real income or actual spending power would not have increased at all above last year's level of $20,000. Yet their income tax would rise to $2,210, and, more importantly, their effective tax rate would rise from 9.5 percent in 1979 to 10.3 percent in 1980. If this high rate of inflation were to continue for 10 years, this family, on the same real income, could see its effective tax rate climb to 19.8 percent, almost double what it had been in 1979--if, and this is a big if, Congress did not make any income tax changes during the intervening period.

In this instance, what is true for an individual family is true for taxpayers as a whole. If we experience 10 percent inflation, as we have over the last 12 months, individual income tax receipts rise not by 10 percent, but by something closer to 15 percent. In the technical jargon of economics, the elasticity of the income tax with respect to inflation is about 1.5; that is, tax receipts rise one and a half times as fast as the rate of inflation. Does this mean that everyone's taxes will be 15 percent higher this year than last? Not at all, because the tax law has been changed and the change came not through automatic indexation but through deliberate action of Congress. In fact, this is the way in which the United States tax system has generally responded to changes in income, both real and inflationary.

Since World War II, the rate of inflation has ebbed and flowed, but the trend of prices has always been upward. Does this mean that the effective tax rate on individual income has been constantly rising over time? Not at all. Congress has in fact taken frequent action to reduce individual taxes so that the individual income tax as a percentage of personal income has actually fluctuated in a rather narrow band. Since 1951, the average effective tax rate has ranged from a low of 9.2 percent (in 1965), to a high of 11.6 percent (in 1969 when the 10 percent surcharge was in effect).

It is not just inflation which pushes taxpayers up into higher tax brackets. Because the real productivity of the American economy has been rising, in the absence of

offsetting legislation, our tax bills would also have risen, given our progressive rate structure. This would have been true even if there had been no inflation. Thus, the fact that income taxes as a percent of personal income have not risen, means that Congress, with its periodic tax cuts, has been offsetting not only the impact of inflation on tax rates, but also the impact of the growth of real per capita income. In fact, if Congress had not cut taxes periodically but instead had enacted automatic indexation by adjusting the individual income tax for inflation on the basis of the Consumer Price Index of 1960, taxes paid since that time would have been higher than they have been under the actual tax laws which have been in effect.

Thus, I think the question we should ask is not: should we adjust the tax system for inflation? But rather, <u>how</u> should we adjust the tax system for inflation: by an automatic process called indexation or by periodic legislative readjustments?

<u>Automatic Indexation</u>

Many people favor automatic indexation because they believe that in the absence of such adjustment, the government would automatically increase its share of the total economy as inflation generates additional taxes. Thus, they believe the government "benefits" from inflation. This view is mistaken. The historical record, mentioned above, shows that the response of the Federal Government to an upward trend in effective tax rates has <u>not</u> been to launch new expenditure programs, but rather to reduce taxes. As the work of this Committee shows, government programs are not expanded just to spend increased tax revenues. Rather, the Congress adjusts both taxes and expenditures in order to achieve an overall budget surplus or deficit as it deems appropriate. Automatic indexation by itself would lead to neither a smaller nor a larger government sector.

Next, the argument is sometimes made that automatic indexing is desirable because Congress should not have to "be bothered with" an inflation adjustment every year. It is true that the automatic nature of indexation systems removes the need for frequent oversight by Congress, but this argument works both ways. The argument could be made equally well, that encouraging the Congress to take a more frequent look at what is happening to the tax system may in itself be desirable. Also, even with indexation, Congress would have to adjust taxes downward periodically to offset the impact of rising real per capita incomes.

The final argument, and one which I find very important, concerns the impact of automatic indexing on overall fiscal stabilization policy. At times inflation can represent an

excess of purchasing power relative to the amount of goods and services available, and in those cases it is tax increases that are called for. Automatic indexation of the tax system, whatever its appeal on equity grounds, moves in the opposite direction. That is, under indexation, inflation would give rise not to tax increases but rather to tax cuts or at least, in real terms, no change in effective tax rates. No one welcomes tax increases, whatever their source, and citizens faced with rising prices for almost everything they buy may call for tax "relief" to offset high prices. However, if such "tax relief" merely yields an automatic increase in the amount of after-tax dollars chasing the same amount of goods, consumers have not really improved their position. I feel the country would be better off if Congress were to continue its existing ad hoc approach to the timing of tax increases and decreases, rather than to accept the perverse effects of such an "automatic" system.

There have been occasions when we would have been better off with an automatic tax reduction--1974 or 1975 might have been such occasions, given the increasing rate of unemployment. But in general, if all we know about the economy is that it has been experiencing inflation, economists would generally prefer to have taxes going up rather than going down. If the appropriate fiscal policy calls for a tax reduction, Congress can provide that reduction.

Income Measurement

The second and much more difficult issue concerning indexation is the definition of income and specifically the measurement of real income from capital. For a tax system based on ability to pay, the ideal tax base is real income. With reasonable price stability, nominal income provides a satisfasctory approximation of real income, but under inflationary conditions, this is no longer the case. Particularly severe problems arise in four areas: depreciation of fixed assets, inventory accounting, capital gains, and financial instruments.

It may well be that making only some adjustments for inflation, say depreciation, and not others will increase the inequities and inefficiencies of the tax system. There is, however, an important difference between the adjustments for depreciation, inventories, and capital gains and the adjustment for debt. If depreciation, inventories, and capital gains are based on historical costs, nominal income is not properly measured in terms of current dollars. Therefore, as prices increase, effective tax rates rise, resulting in transfers from private sector to the government. Interest rates, however, are a current price, even if established by long-term contracts. Moreover, if financial instruments are not adjusted, most of the transfers are within the private sector from creditors to debtors.

Depreciation

Generally, fixed assets are depreciated on the basis of their historical cost. It is easy to see that this is inappropriate in a period of inflation because the dollar value of depreciation allowances will be worth less, as time goes on, than the "real" value of the assets being used up. Unfortunately, while the problem is clear, the solution is not: there has been much controversy in recent years, both here and abroad, concerning the appropriate accounting for depreciation of fixed assets in a period of inflation. One possible approach would be to adjust depreciation for each asset based on replacement cost, which would involve calculating a separate price index for every kind of asset. Even aside from the great difficulties in adjusting for quality changes and technological innovations over time, it is clear that the sheer numbers and recordkeeping involved here would lead to a very cumbersome system. Moreover, such practice would allow real changes in relative values to escape taxation. Another possibility would be to index on the basis of some measure of the general price level. Such a measure would refer not just to the prices of capital assets, but would be a reflection of the value of the dollar in broader terms. This approach is preferable to replacement cost depreciation on both simplification and equity grounds.

Although Congress has not legislated explicit inflation offsets for depreciation, accelerated depreciation and ADR provisions have actually provided such offsets. In fact, until the high inflation rates experienced in the last few years, the use of accelerated depreciation on an historical cost basis has generally meant higher depreciation deductions (and hence lower income taxes) than if the law permitted straight-line depreciation on a replacement cost basis. The Commerce Department has estimated the net effect of these adjustments (accelerated depreciation and replacement cost accounting) on Capital Consumption Allowances, which is the National Income and Product Account concept analogous to depreciation and amortization. For corporations, the net effect was positive (i.e. lower taxes) for the years 1962-1973, while for the years since 1974, it has been negative. That is, for the last few years of high inflation, replacement cost depreciation on a straight-line basis would have meant lower taxes, whereas for earlier years historic cost depreciation on an accelerated basis meant lower taxes. (For sole proprietorship and partnerships, the net effect has been lower taxes ever since 1946.)

Inventory Accounting

In the area of inventories, the current LIFO (Last In, First Out) system of accounting is in fact a form of inflation adjustment similar to replacement cost

depreciation. Under this method, real changes in the relative values of inventories escape taxation as long as the firm is growing. Some have argued that it would be more appropriate to require FIFO (First In, First Out) inventory accounting but to permit an adjustment to reflect the change in the general price level from the time the item was put in inventory until the time it was removed from inventory and sold. Such a system, while eliminating purely "inflationary" profits, would still include in the tax base real gains and losses from changes in the relative values of inventories, but it would be much more complex than the LIFO method. Most analysts feel that the present LIFO system adequately handles the problem of inflation as far as inventories are concerned.

Capital Gains

One of the clearest areas in which inflation has an impact is capital gains. If an asset's market value increases due solely to inflation, the holder of that asset has really experienced no increase in wealth, yet he is required to pay a capital gains tax on the difference between the original purchase price and the sales price. This impact of inflation has, in fact been one of the key arguments in defending the favorable tax treatment of capital gains. The present 60 percent exclusion of net long-term capital gains does indeed provide an offset for inflationary gains. However, in any given case it is usually either too much or too little; only rarely would inflationary gains amount to exactly 60 percent of the total gain. Also, since taxpayers may borrow to carry capital assets, the proper taxation of capital gains under inflation depends crucially on the way financial instruments are handled, and that is the area I would like to discuss next.

Financial Instruments

If an individual earns an interest rate of five percent on a $1,000 savings account, at the end of the year he would have $1,050. Suppose, however, the rate of inflation has been seven percent over the course of the year. This means that at the end of the year the individual has not, in real terms, gained from his investment, for he has less purchasing power than he did at the beginning of the year. His $1,050 is actually worth only $981 in terms of beginning-year prices. Even though he is experiencing this $19 decline in real purchasing power, under current law he must include $50 in his taxable income rather than taking a tax deduction of $19 for his loss of purchasing power.

On the other hand, consider a debtor who is able to pay off his debt in deflated dollars: he actually benefits from inflation. Yet, for tax purposes, he may deduct all of his interest payments--even those which merely reflect inflation.

Considering both creditors and debtors, it is therefore clear that inflation produces both gainers and losers in terms of real income, and this asymmetry poses real problems for any practical system of indexation. Suppose for example, an investor purchases an asset for $1,000 and finances it entirely by debt. Would he be helped or hurt by inflation? The answer is that if the holding period of the asset and the debt are the same, the investor is completely protected from the effects of inflation; any inflationary loss on the asset is exactly offset by a gain on the debt. This suggests that it probably would be inappropriate to permit a full inflation adjustment for the investment if no offsetting adjustment is made for the debt.

There is currently no agreement among economists, accountants, or businessmen on just how an adjustment for financial instruments should be made. Some have argued that the interest deduction should be reduced by the amount of interest attributed to inflation, i.e., the "inflation premium." Of course, this would require an estimate of how much of the current nominal rate of interest is "real" and how much is just an inflation premium. Others have suggested that the full interest deduction should be permitted and the full amount of interest income taxed, but at the time debt is paid off, a gain or loss should be recognized to the extent that the debt is paid off with deflated dollars.

Market Adjustments

We generally speak of the changes in value resulting from inflation as if they were always unanticipated, but this is not really the case. No one, for example, thinks that the price level 12 months from now will be precisely where it is today. Everyone anticipates some rise in prices, and lenders, as well as borrowers, take this into account in deciding the terms of a loan.

If the real rate of interest, that is, the rate for stable prices, is three percent, lenders will not continue lending money at three percent when the rate of inflation is five percent. Instead, they will demand a higher rate of interest. How much higher initially depends on the lender's tax rate, for he will try to maintain his after-tax rate of return. Suppose a lender's marginal tax rate is 50 percent; under stable prices, his after-tax rate of return is 1-1/2 percent. If inflation now rises to five percent, he will seek to raise the before-tax rate not just to eight percent (i.e., three percent + five percent), but to 13 percent, because after he pays taxes on 13 percent he will have 6-1/2 percent left, which in real terms (subtracting five percent for inflation) is the same as the 1-1/2 percent he was earning before inflation.

Thus, in this case the market rate of interest would adjust so that no inflation adjustment would be necessary for the lender. What about the borrower? If he is in the same tax bracket, no adjustment is necessary for him, either. In the absence of inflation, he had to pay three percent, but this was a deductible expense on his tax return, so his after-tax, real cost was 1-1/2 percent. Now he has to pay 13 percent interest, but this too, is deductible so after taxes he pays only 6-1/2 percent, and he is repaying the loan in depreciated dollars, so his real cost is again, 1-1/2 percent.

To the extent that market rates of interest adjust for anticipated inflation, then, it would appear that no tax adjustment for debt instruments is necessary. There are three qualifications to this, however. First, creditors and debtors may not be in the same tax bracket, so any rise in the rate of interest will have certain redistributive effects between them. Second, many people feel that the market does not fully adjust, that there are always lags and other discrepancies among nominal rates of interest, real rates of interest, and the rate of inflation. Finally, for many creditors there are institutional barriers which prevent them from adjusting their rate of return in response to inflation. Specifically, there are laws setting limits on the rate of interest which may be paid on savings in banks and other financial institutions. In some recent years, these limits have been set lower than the rate of inflation, which means that savings account holders have suffered an actual loss in the value of their assets while paying income tax on their nominal interest receipts.

Conclusion

At rates of inflation above a certain level almost everyone would agree that indexation is desirable. I believe that our present and prospective inflation rates are not at that level. To annually adjust the fixed dollar amounts in the Internal Revenue Code would involve only moderate complexity. Since Congress has periodically cut taxes so that average effective tax rates have not risen, the issue is whether we want tax cuts annually or periodically.

To adjust the legal measurement or definition of income would mean substantially increasing the complexity of the present system and greatly increasing the recordkeeping requirements of individuals and firms. Until there exists a greater consensus within both the accounting profession and the business community concerning the best manner of adjusting financial and operating statements for inflation, it would be inappropriate for the Treasury Department or the Congress to attempt to impose any particular "correct" method. Also, until the business community is prepared to

use an indexed financial statement in reporting to their stockholders and creditors, Congress should not permit the business community to report to the Internal Revenue Service on an indexed basis.

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TESTIMONY BY
GARY C. HUFBAUER
DEPUTY ASSISTANT SECRETARY FOR
INTERNATIONAL TRADE AND INVESTMENT POLICY
DEPARTMENT OF THE TREASURY

Mr. Chairman, you asked the Treasury Department to give your Committee its views on Title II, regulatory reform, of the Omnibus Maritime Bill. We believe, Mr. Chairman, that your bill and these hearings represent a constructive step in our search for improvements in maritime policy.

My remarks this morning are limited to Treasury's initial reaction to Title II. Because the bill proposes far-reaching changes, and because we have had only a few days to study it, I can only give you a preliminary assessment. I hope to have a more definitive Treasury position later.

Before discussing the policy issues raised by this legislation, I would like to review the current economic condition of the U.S. ocean liner trades and the U.S. ocean liner industry. The economic background clearly should be reflected in proposals for policy changes.

First, tonnage carried in the U.S. liner trades has been stagnant since at least 1966, while non-liner and tanker tonnage has grown rapidly. In 1966, 50 million tons of cargo

were transported in the U.S. liner trades. In 1977, that volume actually dropped to 48 million tons. Total tons carried by non-liner vessels, by contrast, increased from 190 million in 1966 to 290 million in 1977, an increase of about 53 percent. Total tanker tons increased by more than 250 percent during the same period. The percentage of total liner tonnage in the U.S. trades carried by U.S. flag vessels increased from 23 percent in 1966 to 31 percent in 1975, and has since remained at about that share.

Second, in discussions on the current health of U.S. liner carriers, attention often centers on the bankruptcy of two U.S. carriers in 1977 and the apparent poor health of some other carriers. But looking at the sickbed does not tell the whole story. According to a recent magazine report, two major U.S. carriers are planning to invest well over a billion dollars in expansion of their fleets over the next few years. This expansion should result in sizable net growth of the U.S. liner fleet. It indicates that a large segment of our fleet is healthy and growing.

The figures show that liner shipping has lost ground in the last dozen years. The clear implication is that liners simply are not competitive with alternative transportation systems. The increase in international trade over this period and greater price competition in the non-liner market have made it worthwhile for shippers to buy or charter entire

vessels rather than use liners. Air transportation too may begin to pull cargo away from liners as air carriers are allowed to compete more freely than in the past.

Our conclusion is that adopting closed conferences, as proposed in this legislation, will not improve the competitive position of the U.S. liner shipping industry. In fact, closed conferences could well worsen the industry's position, if higher rates are sought and tonnage is sacrificed. The end result could be less efficient liner services at higher costs, without any obvious gains for our liner carriers. Bilateral arrangements carving up cargo among carriers might have similar undesirable effects, although these agreements sometimes are necessary in response to foreign restrictions.

We believe a better approach would involve measures designed to end the uncertainty and delay that currently surround federal regulation of ocean shipping. This could be achieved by means of several steps:

-- The FMC should have basic responsibility to confer antitrust immunity and to enforce the Shipping Act;

-- The FMC should grant presumptive approval to conference arrangements that provide the least anti-competitive means of promoting operating efficiency. Such approval would cover agreements providing for terminal sharing and equipment interchange;

-- The FMC should adhere to strict time limits in all its deliberations.

An additional desirable action would be to broaden price competition among liners. Experience shows that this policy has worked in other areas of transportation. No inherent reason exists why it could not also work in ocean liner shipping. A more competitive regime need not involve implemented in one fell swoop; a starting point might be the legalization of effective independent action by conference members and a ban on dual rate contracts. Shippers' councils could also be established to help ensure that carriers meet shippers' needs.

Interestingly, the U.S. carriers that are planning sharp increases in capacity are unsubsidized; those that went bankrupt last year were subsidized. Those companies foregoing subsidies and the accompanying government restrictions on their operations are evidently doing a better job of competing than the subsidized carriers. The more aggressive and efficient U.S. carriers can compete effectively, even under the current regulatory scheme.

It is likely that less efficient carriers would face rough seas under a more competitive course. Temporary safe harbors can, of course, be found. But if our long-term policy with regard to any industry were gauged so as to keep the least efficient producers in business, that policy would prove very expensive both in terms of direct government subsidies and in terms of higher prices.

To sum up, Mr. Chairman, Treasury agrees that our maritime policy could be improved. But it is not clear to us that closed conferences are the answer. Rather, we think the current system, with the reforms I have outlined, can meet the needs of U.S. carriers and shippers.

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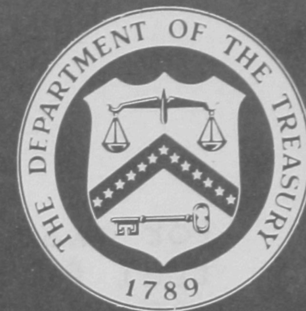

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Tuesday, July 24, 1979

STATEMENT OF THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE SENATE ENERGY AND NATURAL RESOURCES COMMITTEE

Mr. Chairman and Members of this Distinguished Committee:

Introduction

Since these hearings were originally scheduled, President Carter has announced a bold, comprehensive program to reduce oil imports by 4.5 million barrels per day by 1990, including a program for the new production of 2.5 million barrels per day of synthetic fuels and unconventional gas. The details of this program, including the technologies and cost estimates, have been described to you. As requested by the Committee, I shall limit my presentation today to the financing problems associated with synthetic fuels and unconventional gas and to a description of the President's proposed Energy Security Corporation which is designed to overcome these problems.

Financing Risks Associated With Synthetic Fuels and Unconventional Gas

The amount of investment required to construct synthetic fuel plants and to produce unconventional gas is large, and the risks associated with that investment have been judged by private investors to be so great that, as yet, no commercial scale synthetic fuel plant has been built in the United States.

For example, a plant producing 100,000 barrels per day of liquid fuel from coal is estimated to cost 3 to 5 billion in constant 1979 dollars while a plant producing 50,000 barrels per day from oil shale is estimated to cost about $1.25 billion. The capital requirements for a plant producing 50,000 barrels per day of ethanol from biomass are approximately equal to the capital requirements for synthetic liquids from oil shale.

The risks faced by private sector firms in financing a synthetic fuels project are substantial and involve the technologies and marketability of the product. Investors have not been willing to commit sizeable funds to projects involving technologies which have been untested at commercial scales of operation. This is a particular obstacle in the case of coal liquefaction and oil shale. If a plant is unable to operate at sufficient capacity or the technology does not work, the investment may not be recovered. This has been the reason that development of these technologies through pilot projects and demonstration plants before commercial scale production has been proceeding slowly. However, given the goals set by the President, we cannot afford the years of delay that would be required to proceed through a more extensive technical evaluation, and most industry experts agree that the incremental risks of accelerating the process are not unacceptably large. If we do not accelerate the process, 2.5 million barrels per day will not be produced by 1990. Federal financing assistance may be required to assume some of the technological risks associated with at least the first generation of the projects.

The second major risk is the "price risk" which has two elements--the market price of oil and the total cost of construction. Obviously, if the final product cannot be sold at prices sufficient to recover investment and to pay an appropriate rate of return, investors will not be willing to provide funds for the project. Current estimates of the cost per barrel of synthetic fuels and unconventional gas remain substantially higher than the current world price of oil. Because the supply of oil is declining and more costly to extract, sooner or later the costs will be competitive with that of oil. While Department of Energy projections provide a basis for concluding that this is likely to happen in the foreseeable future, private investors are not sufficiently convinced to commit the very large amounts of capital required. A government guarantee of the price of the product will be required until investors become convinced that synthetic fuels and unconventional gas will be competitive.

The other part of the price risk involves the problem of construction costs which directly affect the break even price for synthetic fuels. These overruns can be attributed mainly

to the untested nature of some synthetic fuel technology on a commercial scale, inflation, and delays caused by various regulatory disputes which have led to delays in construction periods. These risks can be partially covered by price guarantees. The Energy Mobilization Board proposed by the President will also assist in reducing the delays and therefore reducing the overruns.

It is difficult to forecast accurately the effect of synthetic fuels investment on our domestic capital markets. Any such conclusions depend upon projections of U. S. economic conditions over the next ten years. Reliance on any such projections is hazardous.

Nevertheless, while the amount of public and private investment required to meet the President's import reduction goals is very large, our capital markets should be able to finance them without severe dislocations. For example, the Department of Energy forecasts that as much as 100 to 160 billion in inflated, nominal dollars of total investment over the 1980-1990 period might be required to meet the President's production goals. This seems like an enormous figure, but it must be compared to estimates of the total capital raising capacity of our economy. Data Resources, Inc. estimates that as much as $5 trillion may be raised over that same period. If these two estimates are even close to accurate, the capital markets impact of this program should not be severe.

The proposed Energy Security Corporation, will have the authority to borrow up to $88 billion from the Treasury to assist in raising these funds. It will be funded by revenues derived from the windfall profits tax. The maximum amount available to the Corporation over the 1980-1990 period would be $88 billion. By contrast the President's proposed windfall profits tax would raise substantially more than this amount over the 1980-1990 period.

Financing Techniques

A variety of techniques may be involved in providing Federal financing assistance to synthetic fuels and unconventional gas projects. It is useful to provide a few hypothetical examples of the financing tasks which will be confronted and the role which the Federal Government might play.

Many coal and shale oil plants would be financed on a project-financing basis by a consortium of large or small companies. Typically, a new entity would be created to

construct and operate the project. The partners would provide equity for the entity which would then raise its own debt capital. Often, this type of financing involves a more highly leveraged project than normal balance sheet financing. Furthermore, the balance sheets and cash flow of the partners may not be sufficient to support the financing. The debt of the project may be secured in whole or in part by either contractual arrangements on product sales which insure that payments will flow to the project to cover debt service regardless of whether product is available or guarantees of the project debt by the partners.

A joint venture might be formed by four medium-sized companies to construct a coal liquefaction plant at a cost of $2.5 billion in 1979 dollars to produce 50,000 barrels per day of gasoline. The joint venture would be capitalized with 25% equity and 75% debt as follows: the partners would provide $625 million of equity and would need to borrow $1,875 million in the private markets. However, because the technology has not previously been tested commercially, lenders might be unwilling to finance the venture, the partners might not have sufficient resources on their own to guarantee this large amount of debt because of restrictions in their outstanding loan agreements or for other reasons. The project might not be built, therefore, unless the Federal government could provide guarantees, at least until the project had commenced commercial production and perhaps for the duration of the long-term financing.

Even if the technological and credit risks can be overcome, the major problem faced may be the marketability of the products. For purposes of illustration, an oil company, two large coal companies, and two utilities might become joint venture partners in a coal liquifaction plant producing gasoline and other by-products. Contracts would be negotiated with the oil companies and one of the utilities to purchase the entire output of the project at the then current world price. The credit of the purchasers might be sufficiently strong at a fixed price, but the partners could be unwilling to assume the risk that world oil prices will be below the cost of producing the synthetic fuel. The Federal Government could provide price guarantees to the project so that if the world price is below the cost of the product, the project would be compensated for this differential and have sufficient funds to repay the debt and provide a return to the partners.

In some situations, it may be that the technical and price risks associated with a project are so significant that the least expensive way for the project to be completed would

be for the Federal government itself to assume all the responsibilities for construction and start-up. In effect, the project would be completed on a government-owned basis through the use of a private contractor and operated at least initially by a private sector contractor under a management contract. The plant, if successful, would be sold into the private sector as promptly as practicable.

I should stress that although we believe these to be representative alternative financing scenarios, it is simply not possible to predict in advance what form the financing should take in the case of each project--and there may be upwards of 40 involved--in order to assure that the projects will be completed and that they are completed at the least cost to the Federal taxpayer. For example, the financing devices associated with the development of unconventional gas sources may be quite different from those outlined above.

Thus, it is essential that the Federal entity created to finance or assist in the financing and completion of these projects have authority to use a variety of financing tools to assist synthetic fuels projects. The use of these tools will be determined by the technology involved, the prospect for world oil prices at the time of financing for the project, the partners involved and their financial strength, the regulatory climate, and other important variables.

The President's Energy Security Corporation

In his July 15 speech, the President proposed an Energy Security Corporation which would have broad ranging authority to assist projects which produce synthetic fuels (including liquids and gases from coal, biomass, peat and oil shale) and unconventional natural gas. The Corporation is designed to create a partnership with the private sector to achieve the import reduction goals provided in the President's Energy Program. It will be able to assume the risks which the private sector has been unwilling to assume, and thus provide the missing ingredient to the creation of a synthetic fuel industry. To achieve this result in the most efficient manner, it will be freed of most of the restrictions which impede the ability of government agencies to act quickly and decisively and will be able to attract the most qualified personnel in the United States. In order to minimize the incursion into the private sector, it will sunset in 12 years. At the end of its life, the Energy Security Corporation's assets and liabilities would be transferred to the Treasury Department for settlement and liquidation.

The Administration firmly believes that it is critical to create such a corporation in order to achieve the production goals established by the President. The Energy Security Corporation offers a focused Manhattan-project approach in assisting the private sector development of a synthetic fuels industry, which is consistent with the urgency of reducing our dependence on oil imports.

The Corporation will be a Federally chartered corporation managed by a seven-member board of directors. The Federal directors will include the Secretaries of Energy, Treasury, and Interior. The Chairman and three outside directors will be appointed by the President, subject to confirmation by the Senate for five-year staggered terms. The Chairman will serve as a full time Executive Officer who will be experienced in at least one aspect of planning, construction and financing of production facilities.

The Board of Directors will be authorized to set the compensation for the chairman, the outside directors, officers and employees, and the Corportion's overall personnel levels.

The Corporation will develop domestic production capacity and will not engage in research and development. It will have discretion to use a wide range of tools to assist in reaching its goals including price guarantees, Federal purchases, direct loans, loan guarantees. It will have the power to build up to three plants which will be government-owned and operated or operated by private parties under management contracts. Additional plants may be constructed only if the Chairman determines that the President's production goals cannot be met through the use of the Corporation's other financing powers. If a private sector firm receives a tax credit with respect to the output of a project, that project will not be eligible for financial assistance from the Corporation.

The Corporation will have the authority to borrow from the Treasury up to $88 billion. This authority will be sought in advance but with staggered availability -- $22 billion at the outset and an additional $22 billion every 18 months thereafter. The President will have the authority to postpone the availability of funds depending on the progress of the Corporation.

The Secretary of Treasury will be authorized to purchase from the Corporation its total stock in the amount of $100 million. This will be accomplished by an appropriation available at the time the Corporation is established and will be reflected in the Budget of the United States. The Corporation will use the proceeds to meet administrative expenses.

The operations of the Corporation will not be reflected in the budget of the United States except to the extent transfers are required from the Energy Security Trust Fund. This will insure that outlays by the United States Government to the Corporation will be shown in the President's Budget. Up to $88 billion will be available from the Energy Security Trust Fund for the financing of its loans from the Treasury. It is recommended that annual appropriations not be required and that necessary budget authority be provided at the time of establishment.

The President's program will act to accomplish important national energy objectives but will also provide other substantial benefits to the Nation:

- The investment in synthetic fuels production will reduce our dependence on foreign sources of oil. This dependence increasingly impairs our national security.

- The Corporation will provide the impetus to start the wide scale development of synthetic fuels and unconventional natural gas. The development of these resources must occur in light of our declining reserves of conventional oil and gas. The sooner we develop these resources, the better off we will be.

- The reduction in oil imports will have a very positive impact on our balance of payments and will result in expenditures in our domestic economy that would have been made to foreign nations.

- By removing uncertainty and by guaranteeing adequate supplies of energy, the President's program would increase the propects that the U. S. economy will achieve its full growth potential in the years ahead.

- The President's program will make the United States a leader in advanced technology associated with the production of unconventional and alternative sources of energy. A beneficial spin-off of technology to other fields and productivity gains should also occur.

Despite the freedom from normal governmental restrictions, the President's proposal contains appropriate safeguards to protect the Federal interest.

- Borrowing authority is available in $22 billion tranches.

- Reserves are required to be set up against all contingent and noncontingent obligations when incurred and are charged against the Corporation's budget authority. These reserves are based in part on estimates of future world oil prices.

- Loans and guarantees may be provided only where capital is not available on reasonable terms and conditions; collateral may be required.

- Loan guarantees may not be provided for more than 75% of the initial cost of a project and 60% of any overruns.

- Loan guarantees may be purchased by the Federal Financing Bank, thereby reducing financing costs;
- Fees for loan guarantees must be charged to cover administrative expenses and probable losses.

- Price guarantees must be based on competitive bids, where possible.

- Projects built by the Corporation must ultimately be sold to the private sector; no more than three may be constructed unless necessary to meet the President's goal.

- The Board of Directors is subject to ultimate Presidential control--three members are cabinet Secretaries and one of the other four members' term will expire every 15 months, serving staggered five-year terms.

- The GAO is authorized to conduct annual audits and semi-annual reports to Congress are required.

- Administrative expenses are limited to $35 million annually.

- Obligations are payable out of the Energy Security Trust Fund with a priority over all other uses except tax credits and low-income assistance.

Obviously, mistakes will be made, losses will occur and some unforeseeable problems will develop. However, we believe this type of organization presents the country's best chance to achieve the President's goals.

Energy Mobilization Board

In addition, the President also proposed an Energy Mobilization Board to accelerate the regulatory approval

process for vital energy projects. I wish to acknowledge especially the work that you have done in developing this idea, Mr. Chairman. This board must be created in order to achieve the 1990 targets for domestic energy development and import reduction. The Board would have three members and will be located in the Executive Office of the President. The members of the Board will serve at the pleasure of the President and will be confirmed by the Senate.

The Board would be authorized to designate certain non-nuclear facilities as critical to the Nation's import reduction goals and to establish schedules for Federal, state and local decision-making with respect to those projects. No more than 75 projects could be assisted at any one time. Expedited judicial review procedures would be established through the Federal Courts of Appeals for the jurisdiction in which the project will be built. If a Federal, state, or local agency failed to act within the established schedule, then the Board will have authority to make the decision in place of the agency but applying the appropriate Federal, state, or local law. The Board will also have the authority to waive procedural requirements of Federal or local laws. To avoid delays after construction has started, the Board could waive the application of new substantive or procedural requirements of law which came into effect after construction of a project has commenced. Waivers would be granted on a case-by-case basis. Waivers would also be subject to a Presidential veto.

A copy of the detailed specifications for the Energy Mobilization Board is attached for insertion into the record.

Conclusion

In summary, the President has outlined a bold program to reduce our Nation's reliance on oil imports by 4.5 million barrels by 1990. This program is critical to preserving our national security and economic health. The Administration looks forward to working with Congress to achieve this objective through enactment of the appropriate legislation. I urge your support for the President's import reduction measures including the establishment of the Energy Security Corporation to encourage the development of synthetic fuels and unconventional natural gas.

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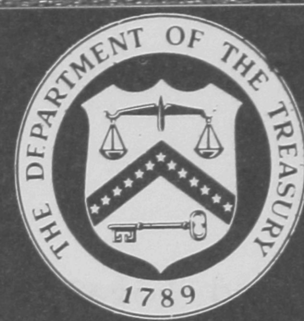

For Release Upon Delivery
Expected at 10:00 A.M.
Tuesday, July 24, 1979

STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE
BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL RELATIONS
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

Mr. Chairman and Members of the Subcommittee:

I appear before you to discuss the Administration's past experience with the General Revenue Sharing Program and certain aspects of its future. We in the Treasury Department have devoted a great deal of attention to the evaluation of this major program during the past several months. While we have not yet formulated recommendations on the future of GRS, we have been exploring a wide variety of options.

Concerning the Federal budget effects of this program, the Administration's position is that it should be funded at current levels through September 30, 1980 -- when the current statute expires. In 1976, Congress extended this program for four years and recipients understandably have assumed that they could depend on these funds for that period. We do not favor, therefore, any immediate change.

Beyond fiscal 1980, the General Revenue Sharing Program clearly must be evaluated relative to the other important demands on limited Federal resources. There is no doubt that to the degree that this program contributes to a healthy Federal system and supports the vital activities of States

and localities, it should have high priority. Nevertheless, we are weighing these positive aspects of revenue sharing against the need for a balanced Federal budget, the needs of other programs, the current health of the State and local sector, and the possible need to better direct Federal assistance to the most needy communities and the most serious problems.

Regarding the fiscal condition of State and local governments, there have been considerable surpluses in that sector in recent years. I should sound two cautionary notes, however. First, the NIA data on State and local finances is not flawless. In addition, since the beginning of 1978, there has been a trend toward smaller and decreasing NIA surpluses for this sector.

The current revenue sharing allocation system distributes funds to almost all general purpose governments in the United States essentially on the basis of population, the inverse of per capita income, and tax effort. While it is true that many States and communities receive some funds, the GRS program actually involves a moderate targeting of funds to the advantage of communities which might be considered as fiscally needy.

We at the Treasury are giving careful consideration to alternative formulae for distributing any future program of general fiscal assistance. The role of the States in the program; the use of alternative data and data concepts for distribution purposes; the redefinition of recipient eligibility; and the design of a several-tiered program, each tier with its own purposes, are being explored.

I would like to remind the Members of the Subcommittee that the development of an alternative formula for distributing intergovernmental aid to a sizeable number of governments is difficult both technically and politically. As concerns the first difficulty, there are few alternative measures of need for which there is acceptable quality data. Even if these technical problems could be readily put aside, finding an alternative distribution scheme which will be widely supported is a difficult task. This latter fact is especially true when there is considerable support for the existing pattern of allocations.

Let me turn now to a discussion of how GRS funds are used by recipient governments. To begin, we all know that General Revenue Sharing is a significant source of revenue for the recipient governments. In 1976-77, GRS made up 1.3 percent of States' total general revenue, and about 4 percent

of local general revenue. This source of revenue has allowed many to provide essential services and functions without having to resort to increased taxes or borrowing. Obviously, this is particularly significant for fiscally strained localities, which might be required to cut current services if GRS funds were terminated.

Studies on GRS fiscal impact found that, for fiscal 1973-75, between 50 to 70 percent of GRS funds were used by recipient governments to expand and maintain expenditures on existing functions. Functionally, the expenditure areas most affected by GRS are public safety and transportation. In addition, those earlier studies indicated that State governments transfer a substantial portion of their GRS funds to local governments.

More specifically, actual use data for 1976-77 suggested that 84.7 percent of States' GRS expenditures were for current expenditures, and 68.2 percent of local GRS expenditures were for this purpose.

Education accounted for slightly more than half of reported State GRS expenditures in 1976-77. The other functions on which GRS funds were reportedly expended were health and hospital, transportation and public welfare.

About 44 percent of all State GRS expenditures were intergovernmental payments to local governments, mainly for education. Concerning localities, they expended GRS funds primarily on health and hospitals, public safety, and highways. In particular, fire and police protection accounted for 18.9% and 26.6%, respectively, of all GRS expenditures by municipalities in 1976-77.

Finally, Mr. Chairman, you and other Senators on the Subcommittee are aware, I am sure, that the 1976 amendments to the revenue sharing statute placed extensive nondiscrimination, auditing, and public participation requirements on GRS recipients. Unfortunately, the Office of Revenue Sharing has only limited resources to administer these broad and somewhat unique requirements.

With a civil rights staff of less than fifty, ORS has since 1976 attempted to seriously enforce the nondiscrimination requirements of the statute. In the case of States and larger communities, much of the compliance actions called for by these requirements would have resulted anyway from compliance with other Federal laws or from State and local actions. However, the revenue sharing law brings requirements of nondiscrimination for a broad array of protected employment

classes to many smaller governments which have little other contact with the Federal government.

Compliance with the audit requirement imposed in the 1976 amendments -- that all recipients receiving $25,000 have an audit once every three years according to generally accepted auditing standards -- is now being evaluated. The Office of Revenue Sharing has depended to the degree possible on State audit agencies to administer this responsibility. Nevertheless, it still must review many audit reports submitted to it. There is considerable evidence that this aspect of the 1976 amendments has caused positive changes in State and local practices.

There are also reasonably extensive procedural requirements placed on GRS recipients to assure that the public is given an adequate opportunity to participate in decisions about how GRS funds are to be used. Again, our personnel resources for assuring compliance are not extensive. However, we have done our best to respond to complaints received. In many instances, States and localities have been following procedures similar to those in the GRS statute under their own laws and practices.

Mr. Chairman and Members of the Subcommittee, I will now be happy to respond to any questions you may have.

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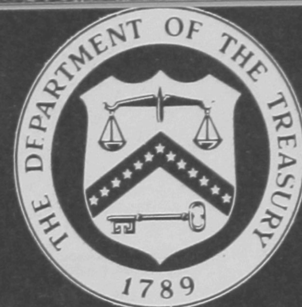

PRESS CONFERENCE
OF
THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
JULY 19, 1979

ASSISTANT SECRETARY LAITIN: As you may have guessed, I am now introducing to you for the last time, Secretary Blumenthal.

SECRETARY BLUMENTHAL: I am delighted to see that the press corps has swollen by this remarkable extent. But I have come to tell you what is obviously by now no longer news: Namely that I met with the President this afternoon at 1:30 to discuss my situation with regard to the general offer of resignations which the cabinet had extended at the meeting on Tuesday. I told the President that my offer was not pro forma, that I had determined that it was in his best interest, as well as in mine, that I step down as soon as possible and that I did want to leave. The President concurred in that judgment and he told me that it was his intention to nominate the Chairman of the Federal Reserve Board, Mr. Miller, to succeed me. And I indicated to him that I was delighted with that choice, that I thought that it was a very good one, that I felt that it was an assurance that the economic policies with which he had been identified for the last two and one half years and in which I had attempted to assist him in their development and their implementation would be continued and that that was a very good guarantee for the continuity of what I think are sound and sensible economic policies.

I also agreed with the President that I would carry on so as to strengthen that continuity until Mr. Miller can be available to take over here, which I hope will be very soon.

I merely want to say that I am satisfied that the last two and one half years have been good ones. I am satisfied that the economic policies with which I have been identified and for which I have worked and helped the President on are the right ones. And I am quite sure that the President will continue to put at the top of his agenda the fight against inflation, the expansion of our energy resources, so as to substitute for imported sources of energy, and continued policies of proper fiscal and budgetary restraint and the expansion of what has come to be known as the supply side of the economy. So I am happy with the turn of events and will be here for some time until Mr. Miller can take my place.

B-1749

QUESTIONER: Why did the President accept your resignation and why did you offer it? Is it a question of policy or is it a question of a personal dispute that perhaps you are not perceived as a team player?

SECRETARY BLUMENTHAL: I obviously am not in a position to repeat to you the entire half hour conversation between myself and the President. But I can tell you in general terms what I told the President. I told the President that I felt that after two and a half years it was, from my point of view, time to return to the private sector, that I felt that I had done as much as I could to help him in the shaping and administering of economic policies, thatI felt that I needed a rest, was ready for it. And I felt that it was, best for him and best for me if I resign. He concurred in that assessment, he accepted my resignation and that was the gist of it.

QUESTIONER: What did you feel?

SECRETARY BLUMENTHAL: I think that given the fact that I feel that I would like to leave, that I have done as much as I can and that obviously he is making a number of changes, that this was the right moment for him to do this and I'm quite satisfied that he has accepted my resignation and will be carrying on.

QUESTIONER: Were you telling the President that you could not handle the job anymore or was it the conditions under which you were conducting your job?

SECRETARY BLUMENTHAL: I stand on what I've said. Obviously, I would not -- I did not tell him that I could not handle the job. I feel that I have handled the job well. I have handled any job that I have done well. So that isn't the problem. But I really have to stand on what I've told you.

QUESTIONER: Did you feel the offers of resignation were something less than voluntary, that you were cornered into offering your resignation?

SECRETARY BLUMENTHAL: No, I think that the entire cabinet felt that the President should be given a free hand, they did so. All the cabinet members as far as I could tell -- you'll have to ask them individually -- did so without any coercion at all. They felt that that was only proper. We all serve at the pleasure of the President. Certainly I have told you that in my case there was no coercion at all and that it was entirely voluntary as far as I was concerned.

QUESTIONER: How long have you been contemplating resigning and returning to the private sector?

SECRETARY BLUMENTHAL: I've been giving it some thought for some time, for some months.

QUESTIONER: What do you think of the whole process that the Administration is now going through of restructuring itself?

SECRETARY BLUMENTHAL: Well, I really think you should ask the President and his spokesman to explain the process. That's not for me to do. Clearly, the President feels that he would like to make a number of changes. He is doing so on the staff, he is doing so on the cabinet. That is his privilege. It is a fact that this team has been together, probably longer than most other teams have. What are all of the details of the thinking, I don't know and I think you should ask him.

QUESTIONER: While testifying, you suggested that this process may have been one of the factors in the current financial uncertainty that was having its effect on various markets. Do you feel that it would have been done in a way that would have promoted stability?

SECRETARY BLUMENTHAL: I was not being critical at all. I was being asked why the price of gold has gone up. I indicated I did not know, that I was not able to make that kind of judgment, that I felt that during periods of change and uncertainty -- which related in this instance both to the rapid rise of oil prices, the recent indications that there would be a higher rate of inflation and a lower rate of growth in the United States and the changes in the cabinet that were under consideration -- that all of that created conditions of uncertainty in which it was understandable there would be some such movement. And, again, I would have to stand on that.

QUESTIONER: The President, in his address to the nation Sunday night indicated and endorsed at least tacitly the view of a southern governor who was quoted as saying that some of my cabinet members disloyal and some of my staff undisciplined. Do you consider yourself disloyal?

SECRETARY BLUMENTHAL: Certainly not. And I would have to say to you, to the best of my knowledge, neither does the President.

QUESTIONER: Mr. Solomon, Mr. Bergsten, do they go too?

SECRETARY BLUMENTHAL: I certainly hope and expect that the very able group of people that I have been privileged to work with in the Treasury will be here and will be available to Mr. Miller. I have no knowledge of anyone intending to resign.

QUESTIONER: (inaudible)

SECRETARY BLUMENTHAL: I did, I told the President that he had an excellent group of people in the Treasury, that I was proud of them, that I felt as proud of turning over to Bill Miller the group of executives that had worked with me in the Treasury as I had been proud to turn over to my successor in the Bendix Corporation the people that had helped me make that one of the best managed companies in the country and that I felt that it was important that that team be recognized and kept together.

QUESTIONER: What did he say?

SECRETARY BLUMENTHAL: He said that he was quite aware, he indicated that he was very much aware of the high quality of the Treasury staff from top to bottom.

QUESTIONER: Have you talked to Mr. Miller, do you have any idea when he will be taking over?

SECRETARY BLUMENTHAL: I have not yet talked to Mr. Miller and I do not know. I have been trying to reach him. I have not been able to reach him.

QUESTIONER: You said your resignation (inaudible). Are you intending to distinguish it from the others in terms of timing or substance?

SECRETARY BLUMENTHAL: No, I was only speaking for myself.

QUESTIONER: In the thirty months that you held this office, what would you say is the accomplishment or the program that you are most proud of?

SECRETARY BLUMENTHAL: I think it is difficult to single out any one particular area or activity. I think that, obviously, the part that we have played in the Treasury and that I have been privileged to play in advising the President in the shaping of his economic policies and the emphasis on the need to fight inflation and the efforts to progressively reduce government spending and move us toward a better balance in the budget -- I think that has been a very important factor that I feel proud of. Second, I think that the successful policies that we have pursued to maintain the strength and stability of the dollar have been a very good and terribly important thing for our country and for our standing in a world context. Third, I believe that the tax policies that have been pursued first under the superb leadership of Assistant Secretary Woodworth, who unfortunately died much too soon, and then under his very able successor Donald Lubick, which resulted in what I thought was a good tax bill that was fair and equitable to all concerned, was certainly something that has been a positive thing.

And in addition to that, all of the other things that we have done in the international organizations, the multilateral development banks, the IMF, many international initiatives under the leadership of Under Secretary Solomon and Assistant Secretary Bergsten and in the banking field under Deputy Secretary Carswell -- all of those things put together will show up, I think, as sound, responsible policies on which the Treasury was helpful, which the President followed and which I'm sure he will continue to follow.

QUESTIONER: Mr. Carter wants to put together a team which is more cohesive in terms of their thinking and their policy and so forth. Now G. William Miller will be coming in to take over the Treasury and has already disputed the Carter Administration's projections on the future state of the economy. He says that the projections were too optimistic. How do you think he is going to do in that context?

SECRETARY BLUMENTHAL: I'm sure Mr. Miller will be fully capable of speaking for himself. Mr. Miller issued a Federal Reserve Board forecast. He is going to have to look at the details of the projections that have been made here in the Council (of Economic Advisers) and then he will have to give you his reply. I am quite confident that the general economic philosophy, his experience, his strength as a former senior business executive, his experience in the Fed equip him admirably for the job as Secretary of the Treasury. I think it's a superb choice. I think he will be very good at it. I think the President has chosen very well. And I think that his views will be quite compatible with those which the President is pursuing and the views with which I have been identified.

QUESTIONER: Do you feel you jumped before you got pushed?

SECRETARY BLUMENTHAL: I took advantage of the opportunity to get paroled with time off for good behavior.

Thank you very much.

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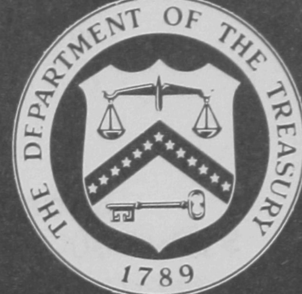

FOR RELEASE AT 4:00 P.M. July 24, 1979

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 August 2, 1979. This offering will not provide new cash for the Treasury as the maturing bills are outstanding in the amount of $6,018 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 May 3, 1979, and to mature November 1, 1979 (CUSIP No. 912793 2T 2), originally issued in the amount of $3,113 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated August 2, 1979, and to mature January 31, 1980 (CUSIP No. 912793 3P 9).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing August 2, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $ 2,788 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, July 30, 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-1750

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. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. 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. 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, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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 on August 2, 1979, in cash or other immediately available funds or in Treasury bills maturing August 2, 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.

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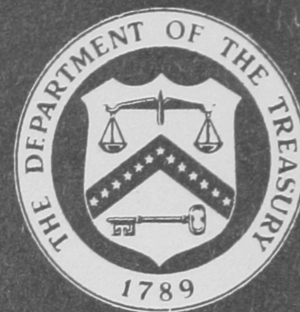

<u>FOR RELEASE UPON DELIVERY</u>

Expected at 10:00 A.M.
Wednesday, July 25, 1979

STATEMENT OF THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

Mr. Chairman and Members of this Distinguished Committee:

I am honored to appear before the Committee this morning to discuss the Administration's proposed program, and various legislative initiatives proposed by Members of Congress, which will assist the development of alternative sources of energy and reduce oil imports by the United States. As President Carter mentioned in his speech of July 15, the Administration is firmly committed to reducing oil imports by encouraging conservation and the production of new sources of energy. Continued reliance on external sources of oil impairs both our Nation's security and economic health. I need not discuss in general terms the energy problems that we face since these conditions are very familiar to you, but will instead focus my presentation on the financing aspects of developing new sources of energy. You have asked me to testify with respect to a diverse collection of bills.

Since your request for testimony before this Committee, President Carter has announced an extensive program to reduce oil imports through conservation and the production of alternative sources of energy. This program will include an Energy Security Corporation to focus the Nation's efforts in achieving the goal of producing two and one-half million barrels per day of synthetic fuels and unconventional sources of natural gas by 1990, and an Energy Mobilization Board to facilitate the approval for siting of energy projects of all types deemed to be critical to increasing production of our domestic energy resources.

General Principles of Energy Financing

Before discussing any of the particular bills in detail, I would like to make some general comments about financing alternative sources of energy. The United States has a very robust private sector which conducts energy activities. While some municipal utilities and rural electric cooperatives are publicly-owned and are the exception, most large utilities which generate and/or distribute electricity and natural gas are private, investor-owned utilities. This Administration firmly believes that the private sector should continue to have primary responsibility for producing, transporting, and distributing energy resources in the United States. An important question is why has the private sector not developed synthetic fuels or widely promoted solar energy? The answer is different in each case.

While competitive when compared to electricity in some parts of the country, solar energy has trouble competing against natural gas and low-priced electricity found in other parts of the United States. Of course, natural gas prices have been controlled for many years, and Congress adopted part of the National Energy Plan proposed by President Carter which is resulting in the phased deregulation of natural gas. As the prices of natural gas, home heating oil, and electricity rise, solar energy should become very economically competitive. The focus of the Administration's effort is to help make solar energy more competitive over the near term by subsidizing the purchase of solar equipment by the consumer. As proposed by President Carter, the Congress enacted certain tax credits for solar installations in residences and businesses, which would assist the consumer by addressing the problem of near-term economics. On June 20, the President announced Administration support for the creation of a Solar Energy Development Bank. The Solar Bank would also act to assist consumers, particularly residential homeowners, by providing interest subsidy payments on loans made by local banks for solar equipment. The President believes it important to get solar development underway.

The development of a synthetic fuels industry faces somewhat different financing problems than solar energy. Synthetic fuels projects suffer from a much more pronounced capital availability deficiency than do solar investments, which are smaller. The former are large, capital intensive projects costing several billion dollars each. There is some degree of technological risk in scaling-up synthetic fuel plants

to commercial level. The construction period alone of a plant would be around four years during which commitment fees and interest during construction must be paid. The market for the end product depends on world oil prices many years into the future, and the anticipated cost of synthetic fuels, especially coal liquids, may be high when compared to market prices for conventional crude oil.

Under these circumstances, it is not surprising that the private sector has proved reluctant to finance large synthetic fuel projects. Therefore, the Administration program proposes a Federal Energy Security Corporation to assist private sector development of synthetic fuels and unconventional gas. It would have a broad range of financial tools including loan guarantees, price guarantees, or purchase arrangements to assist projects. Again, it is the basic thrust of this proposal that the private sector will build and operate the plants utilizing the financial, managerial, and engineering expertise of the private sector.

Financing Risks Associated With Synthetic Fuels and Unconventional Gas

The amount of investment required to construct synthetic fuel plants and to produce unconventional gas is large, and the risks associated with that investment have been judged by private investors to be so great that, as yet, no commercial scale synthetic fuel plant has been built in the United States. For example, a plant producing 100,000 barrels per day of liquid fuel from coal is estimated to cost 3 to 5 billion in constant 1979 dollars while a plant producing 50,000 barrels per day from oil shale is estimated to cost about $1.25 billion. The capital requirements for a plant producing 50,000 barrels per day of ethanol from biomass are approximately equal to the capital requirements for synthetic liquids from oil shale.

The risks faced by private sector firms in financing a synthetic fuels project are substantial and involve the technologies and marketability of the product. Investors have not been willing to commit sizeable funds to projects involving technologies which have been untested at commercial scales of operation. This is a particular obstacle in the case of coal liquefaction and oil shale. If a plant is unable to operate at sufficient capacity or the technology does not work, the investment may not be recovered. This has been the reason that development of these technologies through pilot projects and demonstration plants before commercial scale production has been proceeding slowly.

However, given the goals set by the President, we cannot afford the years of delay that would be required to proceed through a more extensive technical evaluation, and most industry experts agree that the incremental risks of accelerating the process are not unacceptably large. If we do not accelerate the process, 2.5 million barrels per day will not be produced by 1990. Federal financing assistance may be required to assume some of the technological risks associated with at least the first generation of the projects.

The second major risk is the "price risk" which has two elements--the market price of oil and the total cost of construction. Obviously, if the final product cannot be sold at prices sufficient to recover investment and to pay an appropriate rate of return, investors will not be willing to provide funds for the project. Current estimates of the cost per barrel of synthetic fuels and unconventional gas remain substantially higher than the current world price of oil. Because the supply of oil is declining and is more costly to extract, sooner or later the costs will be competitive with that of oil. While Department of Energy projections provide a basis for concluding that this intersection of prices is likely to happen in the foreseeable future, private investors are not sufficiently convinced to commit the very large amounts of capital required. A government guarantee of the price of the product will be required until investors become convinced that synthetic fuels and unconventional gas will be competitive.

The other part of the price risk involves the problem of construction costs which directly affect the break-even price for synthetic fuels. These overruns can be attributed mainly to the untested nature of some synthetic fuel technology on a commercial scale, inflation, and delays caused by various regulatory disputes which have led to delays in construction periods. These risks can be partially covered by price guarantees. The Energy Mobilization Board proposed by the President will assist in reducing the delays and therefore reducing the overruns.

It is difficult to forecast accurately the effect of synthetic fuels investment on our domestic capital markets. Any such conclusions depend upon projections of U. S. economic conditions over the next ten years. Reliance on any such projections is hazardous.

Nevertheless, while the amount of public and private investment required to meet the President's import reduction goals is very large, our capital markets should be able to finance them without severe dislocations. For example, the Department of Energy forecasts that as much as 100 to 160 billion in inflated, nominal dollars of total investment over the 1980-1990 period might be required to meet the President's production goals. This seems like an enormous figure, but it must be compared to estimates of the total capital raising capacity of our economy. Data Resources, Inc. estimates that as much as $5 trillion may be raised over that same period. If these two estimates are even close to accurate, the capital markets impact of this program should not be severe.

The proposed Energy Security Corporation, will have the authority to borrow up to $88 billion from the Treasury to assist in raising these funds. It will be funded by revenues derived from the windfall profits tax. The maximum amount available to the Corporation over the 1980-1990 period would be $88 billion. By contrast the President's proposed windfall profits tax would raise substantially more than this amount over the 1980-1990 period.

Financing Techniques

A variety of techniques may be involved in providing Federal financing assistance to synthetic fuels and unconventional gas projects. It is useful to provide a few hypothetical examples of the financing tasks which will be confronted and the role which the Federal Government might play.

Many coal and shale oil plants would be financed on a project-financing basis by a consortium of large or small companies. Typically, a new entity would be created to construct and operate the project. The partners would provide equity for the entity which would then raise its own debt capital. Often, this type of financing involves a more highly leveraged project than normal balance sheet financing. Furthermore, the balance sheets and cash flow of the partners may not be sufficient to support the financing. The debt of the project may be secured in whole or in part by either contractual arrangements on product sales which insure that payments will flow to the project to cover debt service regardless of whether product is available or by guarantees of the project debt by the partners.

A joint venture might be formed by several medium-sized companies to construct a coal liquefaction plant at a cost of $2.5 billion in 1979 dollars to produce 50,000 barrels per day of gasoline. The joint venture would be capitalized with 25% equity and 75% debt as follows: the partners would provide $625 million of equity and would need to borrow $1,875 million in the private markets. However, because the technology has not previously been tested commercially, lenders might be unwilling to finance the venture. The partners might not have sufficient resources on their own to guarantee this large amount of debt because of restrictions in their outstanding loan agreements or for other reasons. The project might not be built, therefore, unless the Federal government could provide guarantees, at least until the project had commenced commercial production and perhaps for the duration of the long-term financing.

Even if the technological and credit risks can be overcome, the major problem faced may be the marketability of the products. For purposes of illustration, an oil company, two large coal companies, and two utilities might become joint venture partners in a coal liquefaction plant producing gasoline and other by-products. Contracts would be negotiated with the oil companies and one of the utilities to purchase the entire output of the project at the then current world price. The credit of the purchasers might be sufficiently strong at a fixed price, but the partners could be unwilling to assume the risk that world oil prices will be below the cost of producing the synthetic fuel. The Federal Government could provide price guarantees to the project so that if the world price is below the cost of the product, the project would be compensated for this differential and have sufficient funds to repay the debt and provide a return to the partners. In return for providing the price guarantee, the government might also receive a share of the profits if the world market price exceeded the guaranteed price at the time of the completion of the project.

In some situations, it may be that the technical and price risks associated with a project are so significant that the least expensive way for the project to be completed would be for the Federal government itself to assume all the responsibilities for construction and start-up. In effect, the project would be completed on a government-owned basis through the use of a private contractor and operated at least initially by a private sector contractor under a management contract. The plant, if successful, would be sold into the private sector as promptly as practicable.

I should stress that although we believe these to be representative alternative financing scenarios, it is simply not possible to predict in advance what form the financing should take in the case of each project--and there may be upwards of 40 involved--in order to assure that the projects will be completed and that they are completed at the least cost to the Federal taxpayer. For example, the financing devices associated with the development of unconventional gas sources may be quite different from those outlined above.

Thus, it is essential that the Federal entity created to finance or assist in the financing and completion of these projects have authority to use a variety of financing tools to assist synthetic fuels projects. The use of these tools will be determined by the technology involved, the prospect for world oil prices at the time of financing for the project, the partners involved and their financial strength, the regulatory climate, and other important variables.

The President's Energy Security Corporation

In his July 15 speech, the President proposed an Energy Security Corporation which would have broad ranging authority to assist projects which produce synthetic fuels (including liquids and gases from coal, biomass, peat and oil shale) and unconventional natural gas. The Corporation is designed to create a partnership with the private sector to achieve the import reduction goals provided in the President's Energy Program. It will be able to assume the risks which the private sector has been unwilling to assume, and thus provide the missing ingredient to the creation of a synthetic fuel industry. To achieve this result in the most efficient manner, it will be freed of most of the restrictions which impede the ability of government agencies to act quickly and decisively and will be able to attract the most qualified personnel in the United States. In order to minimize the incursion into the private sector, it will sunset in 12 years. At the end of its life, the Energy Security Corporation's assets and liabilities would be transferred to the Treasury Department for settlement and liquidation.

The Administration firmly believes that it is critical to create such a corporation in order to achieve the production goals established by the President. The Energy Security Corporation offers a focused Manhattan-project approach in assisting the private sector development of a synthetic fuels industry, which is consistent with the urgency of reducing our dependence on oil imports.

The Corporation will be a Federally-chartered corporation managed by a seven-member board of directors. The Federal directors will include the Secretaries of Energy, Treasury and Interior. The Chairman and three outside directors will be appointed by the President, subject to confirmation by the Senate for five-year staggered terms. The Chairman will serve as a full time Executive Officer who will be experienced in at least one aspect of planning, construction and financing of production facilities.

The Board of Directors will be authorized to set the compensation for the chairman, the outside directors, officers and employees, and the Corportion's overall personnel levels.

The Corporation will develop domestic production capacity and will not engage in research and development. It will have discretion to use a wide range of tools to assist in reaching its goals including price guarantees, Federal purchases, direct loans, and loan guarantees. It will have the power to build up to three plants which will be government-owned and operated or operated by private parties under management contracts. Additional plants may be constructed only if the Chairman determines that the President's production goals cannot be met through the use of the Corporation's other financing powers. If a private sector firm receives a tax credit with respect to the output of a project, that project will not be eligible for financial assistance from the Corporation.

The Corporation will have the authority to borrow from the Treasury up to $88 billion. This authority will be sought in advance but with staggered availability -- $22 billion at the outset and an additional $22 billion every 18 months thereafter. The President will have the authority to postpone the availability of funds depending on the progress of the Corporation.

The Secretary of Treasury will be authorized to purchase from the Corporation its total stock in the amount of $100 million. This will be accomplished by an appropriation available at the time the Corporation is established and will be reflected in the Budget of the United States. The Corporation will use the proceeds to meet administrative expenses.

The operations of the Corporation will not be reflected in the budget of the United States except to the extent transfers are required from the Energy Security Trust Fund. This will insure that outlays by the United States Government to the Corporation will be shown in the President's Budget. Up to $88 billion will be available from the Energy Security Trust Fund for the financing of its loans from the Treasury. It is recommended that annual appropriations not be required and that necessary budget authority be provided at the time of establishment.

The President's program will act to accomplish important national energy objectives but will also provide other substantial benefits to the Nation:

- The investment in synthetic fuels production will reduce our dependence on foreign sources of oil. This dependence increasingly impairs our national security.

- The Corporation will provide the impetus to start the large scale development of synthetic fuels and unconventional natural gas. The development of these resources must occur in light of our declining reserves of conventional oil and gas. The sooner we develop these resources, the better off we will be.

- The reduction in oil imports will have a very positive impact on our balance of payments and will result in expenditures in our domestic economy that would have been made to foreign nations.

- By removing uncertainty and by guaranteeing adequate supplies of energy, the President's program would increase the propects that the U. S. economy will achieve its full growth potential in the years ahead.

- The President's program will make the United States a leader in advanced technology associated with the production of unconventional and alternative sources of energy. A beneficial spin-off of technology to other fields and productivity gains should also occur.

Despite the freedom from normal governmental restrictions, the President's proposal contains appropriate safeguards to protect the Federal interest.

- Borrowing authority is available in $22 billion installments.
- Reserves are required to be set up against all contingent and noncontingent obligations when incurred and are charged against the Corporation's budget authority. These reserves are based in part on estimates of future world oil prices.
- Loans and guarantees may be provided only where capital is not available on reasonable terms and conditions; collateral may be required.
- Loan guarantees may not be provided for more than 75% of the initial cost of a project and 60% of any overruns.
- Loan guarantees may be purchased by the Federal Financing Bank, thereby reducing financing costs.
- Fees for loan guarantees must be charged to cover administrative expenses and probable losses.
- Price guarantees must be based on competitive bids, where possible.
- Projects built by the Corporation must ultimately be sold to the private sector; no more than three may be constructed unless necessary to meet the President's goal.
- The Board of Directors is subject to ultimate Presidential control--three members are cabinet secretaries and the other four members serve staggered five-year terms, one of which will expire every 15 months.
- The GAO is authorized to conduct annual audits and semi-annual reports to Congress are required.
- Administrative expenses are limited to $35 million annually.
- Obligations are payable out of the Energy Security Trust Fund with a priority over all other uses except tax credits and low-income assistance.

Obviously, mistakes will be made, losses will occur and some unforeseeable problems will develop. However, we believe this type of organization presents the country's best chance to achieve the President's goals.

Solar Energy Development Bank

Solar energy can serve an increasingly important role in meeting our Nation's energy requirements and in reducing our oil imports. Accordingly, the Administration will send to the Congress legislation to create a Solar Energy Development Bank. Before I discuss the Administration's proposal, I wish to acknowledge the important contribution that Senator Morgan of this Committee and Senator Durkin of the Senate Energy Committee have made to this effort.

The Solar Bank proposed by the President would be located in the Department of Housing and Urban Development and would have a strong management structure. The Board of Directors would include the Secretary of HUD as Chairman and the Secretaries of Energy and of the Treasury. Its life would be through 1985 unless extended by an Act of Congress. The Bank would be authorized to make interest subsidy payments on loans originated by private banks. Loans for the purchase and installation of solar equipment in both residences and businesses would be eligible. Limits on the subsidized portion of loans would be limited to $10,000 per unit for a one to four family residential structure, $5,000 per unit for any residential structure with five or more dwelling units (not to exceed $500,000 per loan), and $200,000 in the case of any commercial structure. Sixty percent of the amount of subsidy payments shall be for the purpose of financing solar energy systems in residential structures. It is proposed that the Bank be funded from the Energy Security Trust Fund and that $150 million of such funds shall be available in each full fiscal year during the life of the Bank.

The Administration looks forward to working with Congress for passage of this legislation which will encourage the development of this promising source of energy.

Energy Mobilization Board

In addition, the President also proposed an Energy Mobilization Board to accelerate the regulatory approval process for vital energy projects. This Board must be created in order to achieve the 1990 targets for domestic energy

development and import reduction. The Board will have three members and will be located in the Executive Office of the President. The members of the Board will serve at the pleasure of the President and will be confirmed by the Senate.

The Board would be authorized to designate certain non-nuclear facilities as critical to the Nation's import reduction goals and to establish schedules for Federal, State and local decision-making with respect to those projects. No more than 75 projects could be assisted at any one time. Expedited judicial review procedures would be established through the Federal Courts of Appeals for the jurisdiction in which the project will be built. If a Federal, State, or local agency failed to act within the established schedule, then the Board will have authority to make the decision in place of the agency but applying the appropriate Federal, State, or local law. The Board will also have the authority to waive procedural requirements of Federal or local laws. To avoid delays after construction has started, the Board could waive the application of new substantive or procedural requirements of law which came into effect after construction of a project has commenced. Waivers would be granted on a case-by-case basis. Waivers would also be subject to a Presidential veto.

Conclusion

In summary, the President has outlined a bold program to reduce our Nation's reliance on oil imports by 4.5 million barrels by 1990. This program is critical to preserving our national security and economic health. The Administration looks forward to working with Congress to achieve this objective through enactment of the appropriate legislation. I urge your support for the President's proposal to create a Solar Energy Development Bank, to establish an Energy Security Corporation, and to undertake other import reduction measures.

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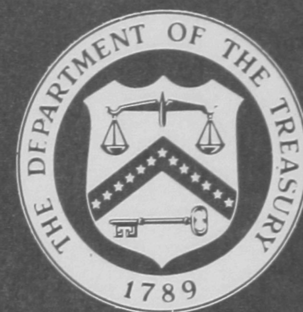

FOR IMMEDIATE RELEASE July 24, 1979

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $3,001 million of $4,669 million of tenders received from the public for the 2-year notes, Series V-1981, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	9.35% 1/
Highest yield	9.45%
Average yield	9.41%

The interest rate on the notes will be 9-3/8%. At the 9-3/8% rate, the above yields result in the following prices:

Low-yield price	100.045
High-yield price	99.866
Average-yield price	99.938

The $3,001 million of accepted tenders includes $ 426 million of noncompetitive tenders and $1,805 million of competitive tenders from private investors, including 96% of the amount of notes bid for at the high yield. It also includes $ 770 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 $3,001 million of tenders accepted in the auction process, $170 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 July 31, 1979.

1/ Excepting 1 tender of $10,000

B-1752

9-3/8% TREASURY NOTES OF SERIES V-1981

DATE: July 24, 1979

HIGHEST SINCE:
MAY 1979
9 3/4% 9.77 YIELD

LAST ISSUE:
9-1/8% 9.22 YIELD

LOWEST SINCE:

TODAY:
9-3/8% 9.41 YIELD

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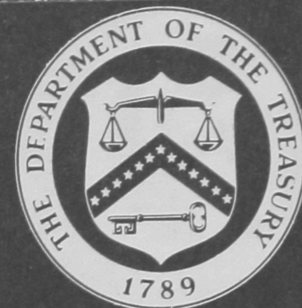

FOR IMMEDIATE RELEASE
July 25, 1979

STATEMENT BY SECRETARY BLUMENTHAL

I am extremely pleased that President Carter has nominated Paul Volcker as Chairman of the Federal Reserve Board. Mr. Volcker's appointment to the Chairmanship follows an already distinguished career in public service, including important service as Under Secretary for Monetary Affairs and as President of the New York Fed.

The combination of Paul Volcker and Bill Miller provides the basis for a forceful and resolute pursuit of responsible anti-inflationary monetary and fiscal policy which recognizes the importance of a stable dollar. The President's appointments to these two important posts are superb.

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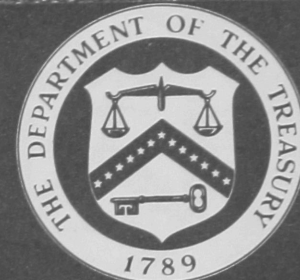
B-1753

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



CONTACT: ROBERT W. CHILDERS
(202) 634-5248

FOR IMMEDIATE RELEASE July 31, 1979

NEW REVENUE SHARING DATA RELEASED TODAY

The data to be used in allocating amounts of general revenue sharing funds to be paid to approximately 39,000 units of State and local general government for Federal fiscal year 1980 were released today by the Department of the Treasury's Office of Revenue Sharing.

Population, per capita income, adjusted taxes and intergovernmental transfer figures are included in the data which are used to calculate the amount of money that each recipient unit of government will receive.

The data released today include revisions which were based upon information supplied by State and local governments in a data review program conducted by the Office of Revenue Sharing in April and May 1979.

The amounts of money which each unit of government will receive will be announced next month. These amounts will be paid in four quarterly installments, in January, April, July and October 1980.

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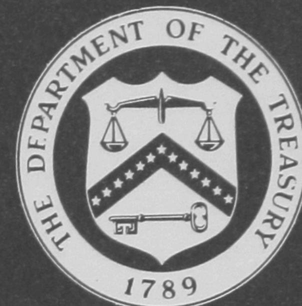

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE July 25, 1979

TREASURY AUGUST QUARTERLY FINANCING

The Treasury will raise about $2,400 million of new cash and refund $4,827 million of securities maturing August 15, 1979, by issuing $2,750 million of 3-year notes, $2,500 million of 7-1/2-year notes and $2,000 million of 29-3/4-year bonds. The 7-1/2-year notes will be an addition to the 9% notes of Series B-1987 originally issued February 15, 1979. The bonds will be an addition to the 9-1/8% Bonds of 2004-2009 originally issued May 15, 1979.

The $4,827 million of maturing securities are those held by the public, including $1,196 million held, as of today, 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 $2,721 million of the maturing securities that may be refunded by issuing additional amounts of new securities. Additional amounts of the new securities may also be issued 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 each of the new securities are given in the attached "highlights" of the offering and in the official offering circulars.

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Attachment

B-1755

HIGHLIGHTS OF TREASURY
OFFERINGS TO THE PUBLIC
AUGUST 1979 FINANCING
TO BE ISSUED AUGUST 15, 1979

July 25, 1979

Amount Offered:			
To the public	$2,750 million	$2,500 million	$2,000 million
Description of Security:			
Term and type of security	3-year notes	7-1/2-year notes	29-3/4-year bonds
Series and CUSIP designation	Series M-1982 (CUSIP No. 912827 JV 5)	9% Series B-1987 (CUSIP No. 912827 JK 9)	9-1/8% Bonds of 2004-2009 (CUSIP No. 912810 CG 1)
Maturity date	August 15, 1982	February 15, 1987	May 15, 2009
Call date	No provision	No provision	May 15, 2004
Interest coupon rate	To be determined based on the average of accepted bids	9%	9-1/8%
Investment yield	To be determined at auction	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction	To be determined after auction
Interest payment dates	February 15 and August 15	February 15 and August 15	November 15 and May 15
Minimum denomination available	$5,000	$1,000	$1,000
Terms of Sale:			
Method of sale	Yield Auction	Price Auction	Price Auction
Accrued interest payable by investor	None	None	$22.81250 per $1,000 (from May 15, 1979 to August 15, 1979)
Preferred allotment	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less
Deposit requirement	5% of face amount	5% of face amount	5% of face amount
Deposit guarantee by designated institutions	Acceptable	Acceptable	Acceptable
Key Dates:			
Deadline for receipt of tenders	Tuesday, July 31, 1979, by 1:30 p.m., EDST	Wednesday, August 1, 1979, by 1:30 p.m., EDST	Thursday, August 2, 1979, by 1:30 p.m., EDST
Settlement date (final payment due)			
a) cash or Federal funds	Wednesday, August 15, 1979	Wednesday, August 15, 1979	Wednesday, August 15, 1979
b) check drawn on bank within FRB district where submitted	Friday, August 10, 1979	Friday, August 10, 1979	Friday, August 10, 1979
c) check drawn on bank outside FRB district where submitted	Thursday, August 9, 1979	Thursday, August 9, 1979	Thursday, August 9, 1979
Delivery date for coupon securities	Wednesday, August 15, 1979	Wednesday, August 15, 1979	Wednesday, August 15, 1979

TALKING POINTS
FINANCING PRESS CONFERENCE

July 25, 1979

1. This afternoon we are announcing the terms of our regular August quarterly refunding. I would also like to discuss briefly the Treasury's financing requirements for the balance of the calendar year.

2. Our refunding will consist of a short-term note, an intermediate-term note and a long-term bond. This is the first three-pronged financing since November 1978. You may recall that we made two-pronged offerings in February and May of this year as a result of small maturities and limited cash needs.

3. We are offering $7.25 billion of new securities to refund $4.8 billion of publicly-held securities maturing on August 15 and to raise approximately $2.4 billion of new cash.

4. The three new securities are:

   -- First, a 3-year note in the amount of $2.75 billion maturing on August 15, 1982. This security will be auctioned on a yield basis on Tuesday, July 31. The minimum denomination will be $5,000.

-- Second, a 7-1/2-year note in the amount of $2.5 billion maturing on Feburary 15, 1987. This is a re-opening of the presently outstanding 9 percent note, which we sold last February. The note will be auctioned on Wednesday, August 1. Since the note is a re-opening of an already outstanding issue, this will be a price auction. The minimum denomination will be $1,000.

-- Third, a 29-3/4-year bond in the amount of $2.0 billion. This is a re-opening of the presently outstanding 9-1/8 percent bond, which we sold last May. This issue matures on May 15, 2009 and is callable beginning May 15, 2004. This bond will be auctioned on a price basis on Thursday, August 2. The minimum denomination will be $1,000.

On each of the three issues, we will accept noncompetitive tenders of up to $1,000,000.

5. For the current July - September quarter, we estimate our net market financing will total about $7 billion, assuming a $15 billion cash balance at the end of September. We may wish to have a somewhat larger cash balance

on September 30, depending upon an assessment of our fourth quarter financing needs later in the current quarter.

6. Thus far, not including this financing, we have raised about $3.5 billion in net new cash in marketable borrowing during this quarter. This was accomplished as follows:
   - -- $2 billion in the 2- and 4-year cycle notes which settled on July 2.
   - -- $1.5 billion of new cash in the 15-year 1-month bond which settled on July 9.

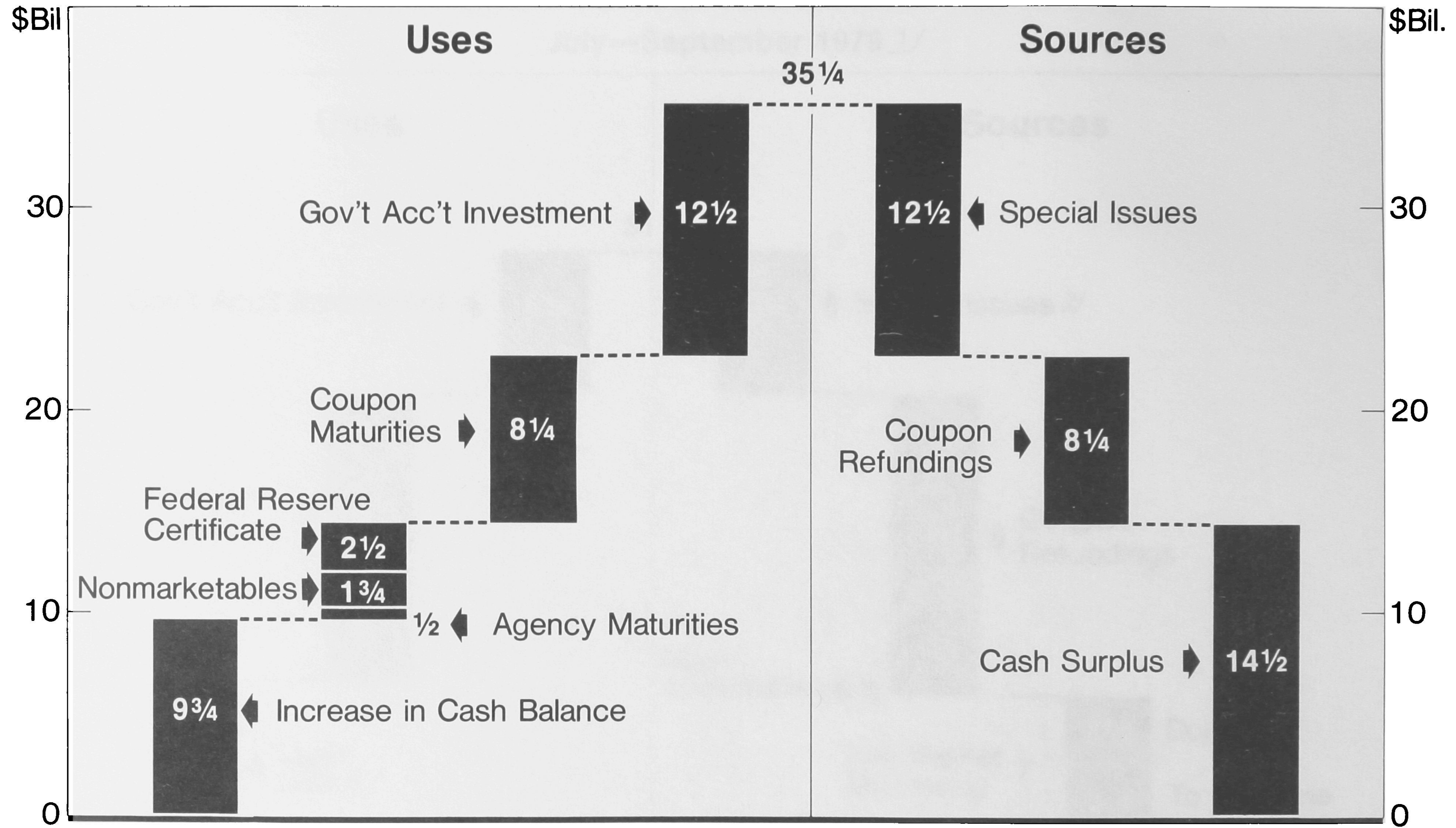
7. The $2.4 billion new cash raised in this refunding will bring the total new cash raised for the quarter to date to approximately $6 billion, leaving a balance of about $1 billion still to be done. This remaining cash need could be easily met by additions to regular bill and note offerings. Also, we will likely need some short-term cash management financing prior to the September 15 tax date. In the event that the remaining cash need increased beyond expectations or that we decided to seek a higher end-of-quarter cash balance, we would consider an intermediate note offering to raise new cash in the first half of September. The maturity of such a note would

likely be in the 5-year area. While we do not presently contemplate an introduction of a new regular series of notes in this maturity area, we would consider an occasional note offering in periods of large permanent financing needs.

8. Our net market borrowing need in the fourth quarter is estimated in the range of $16 - 19 billion, assuming a $12 billion cash balance at the end of December. As a result of this large new borrowing need, coupled with larger than normal maturities in the fourth quarter, we are planning on meeting some of our financing needs in that quarter through additions to weekly bills and/or through cash management bills which would mature in the second quarter of next year.

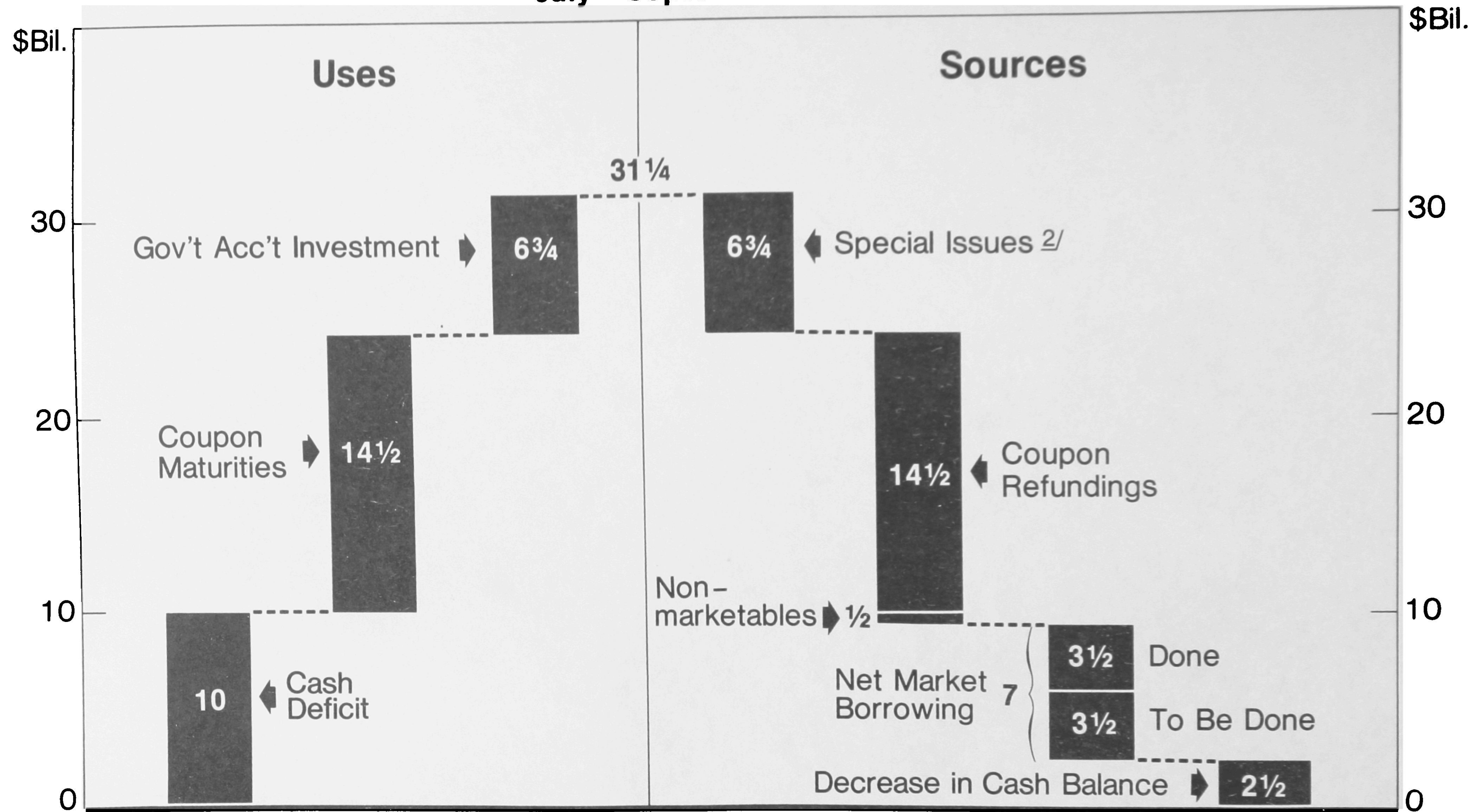
TREASURY FINANCING REQUIREMENTS

April — June 1979



TREASURY FINANCING REQUIREMENTS

July—September 1979 1/



1/Assumes $15 billion September 30, 1979 cash balance.

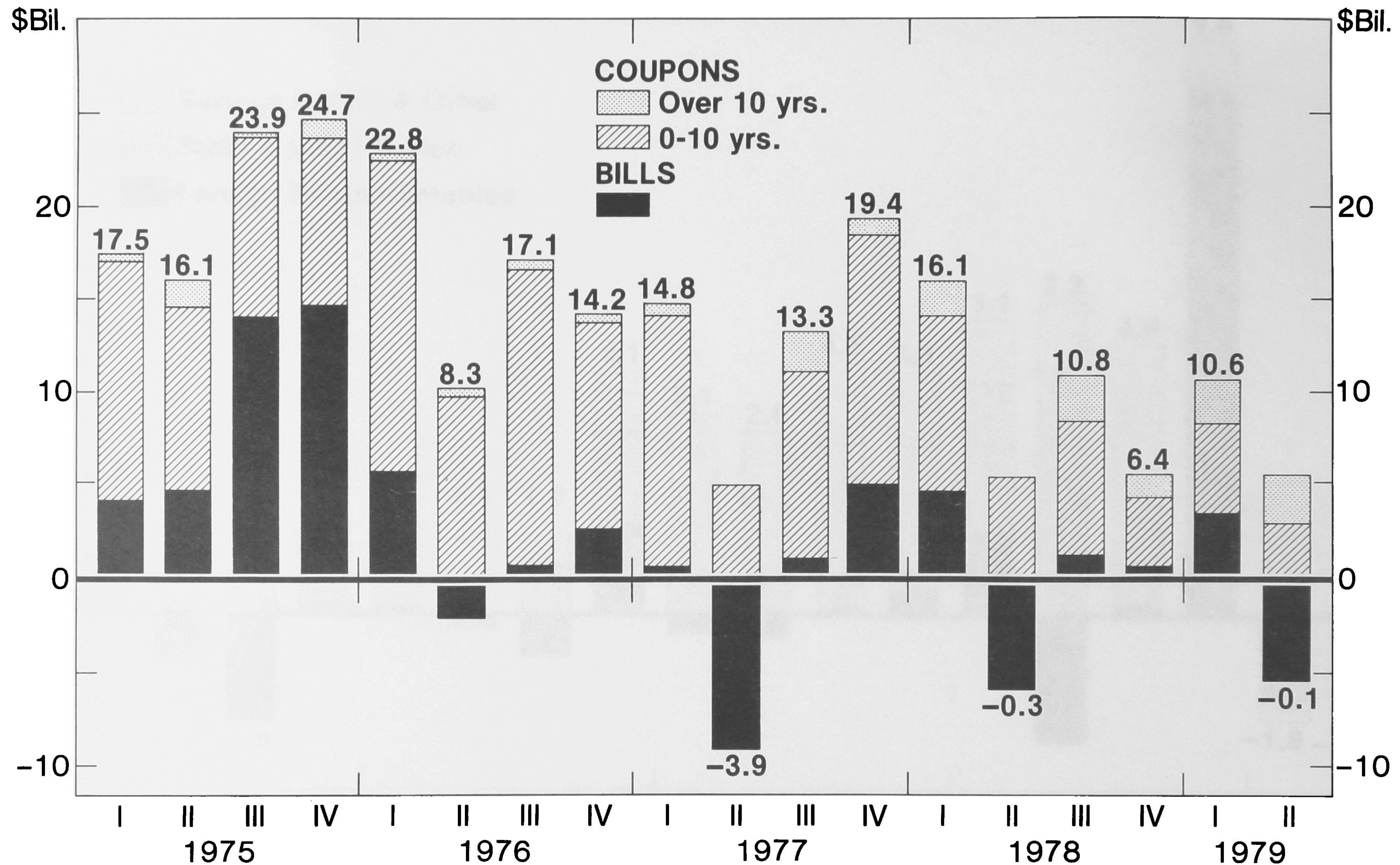
2/Net of exchanges for maturing marketable securities of $¾ billion.

Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-17

TREASURY NET MARKET BORROWING 1/

Calendar Year Quarters



1/ Excludes Federal Reserve and Government Account Transactions.

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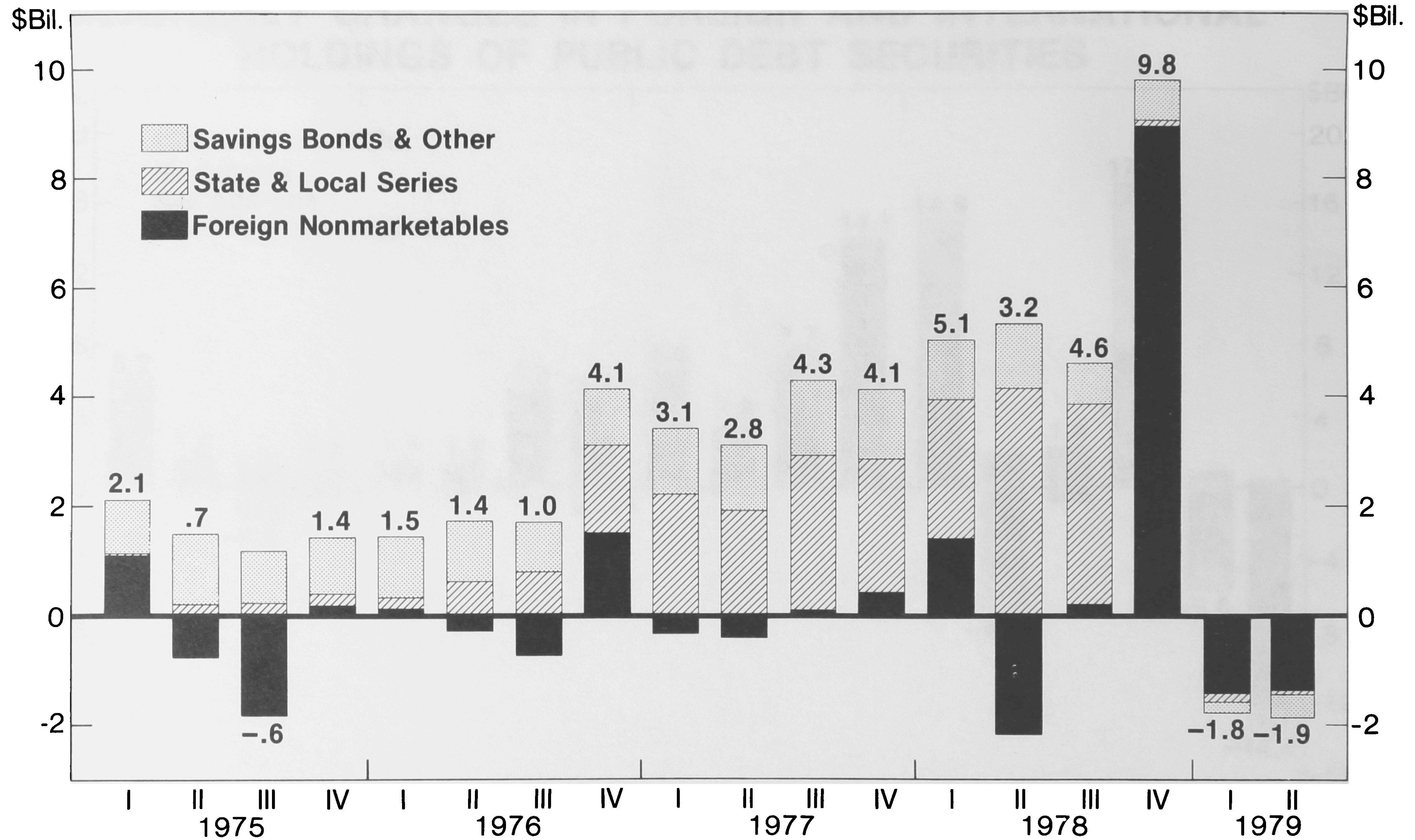
Office of Government Financing

July 24, 1979-6

TREASURY NET BORROWING FROM NONMARKETABLE ISSUES



Office of the Secretary of the Treasury
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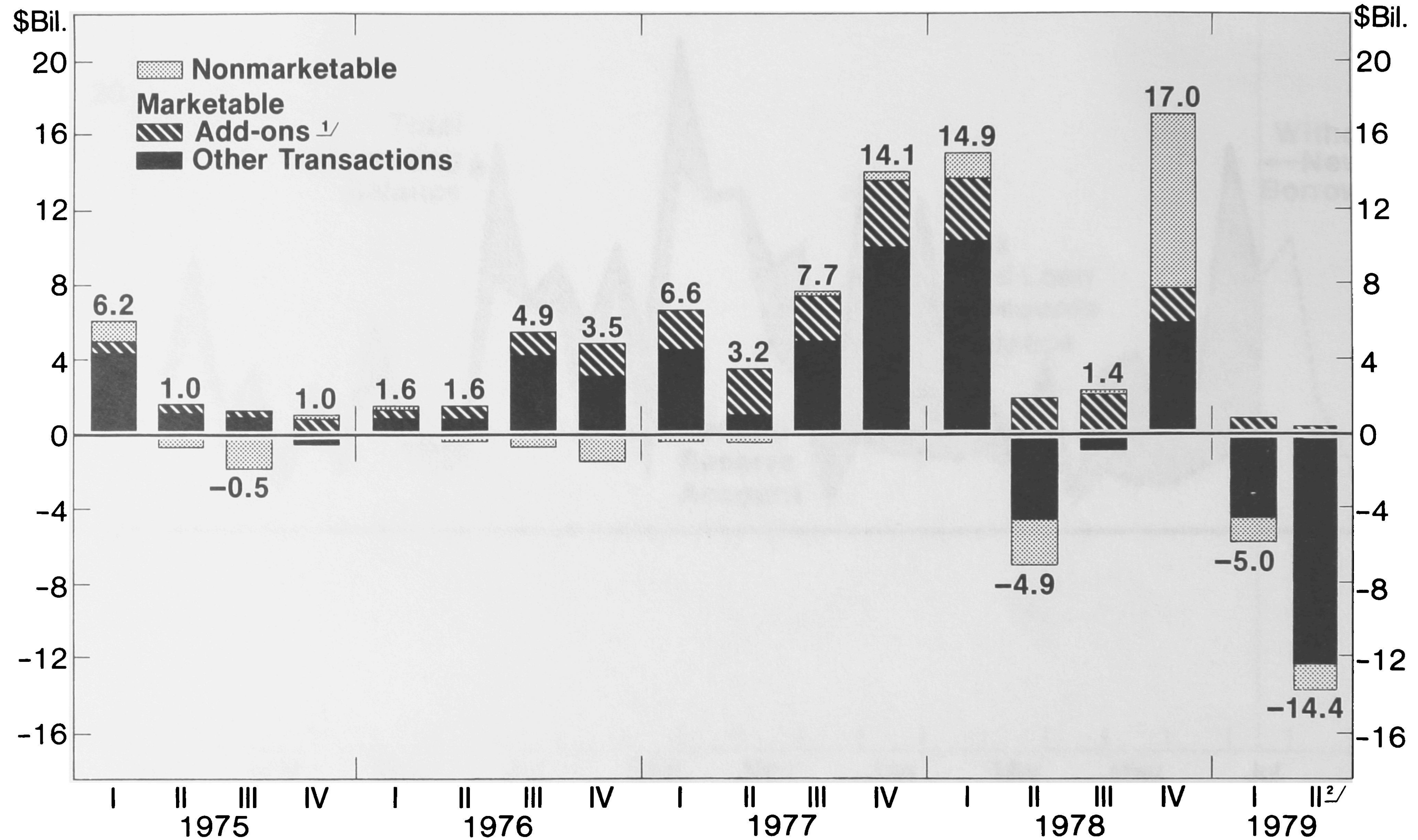
July 24, 1979-3

QUARTERLY CHANGES IN FOREIGN AND INTERNATIONAL HOLDINGS OF PUBLIC DEBT SECURITIES



1/ F.R.B. Purchases of marketable issues as agents for foreign and international monetary authorities for new cash.

2/ Partly estimated.

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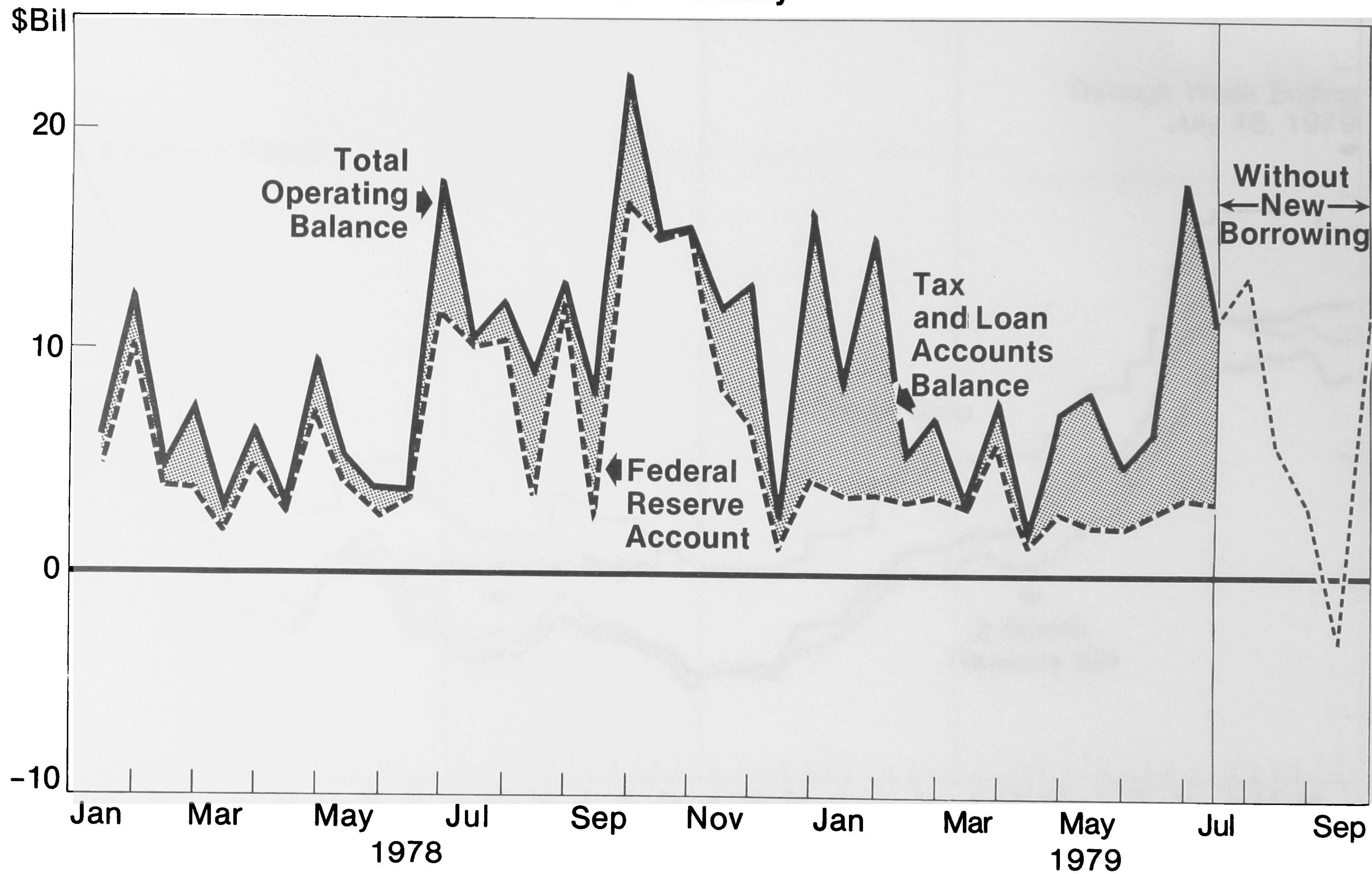
Office of Government Financing

July 24, 1979-2

TREASURY OPERATING CASH BALANCE

Semi-Monthly



Office of the Secretary of the Treasury
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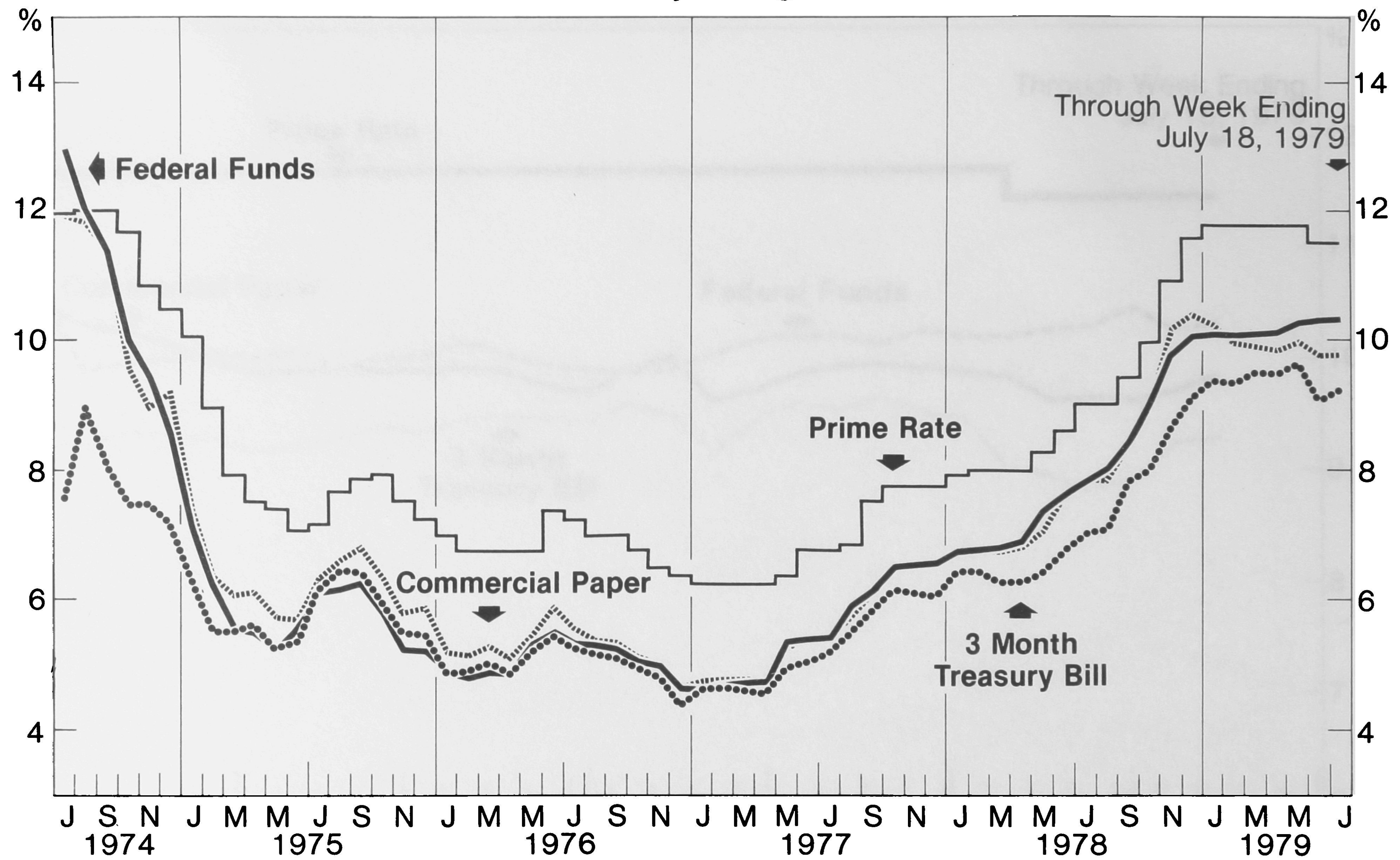
July 24, 1979-12

SHORT TERM INTEREST RATES

Monthly Averages



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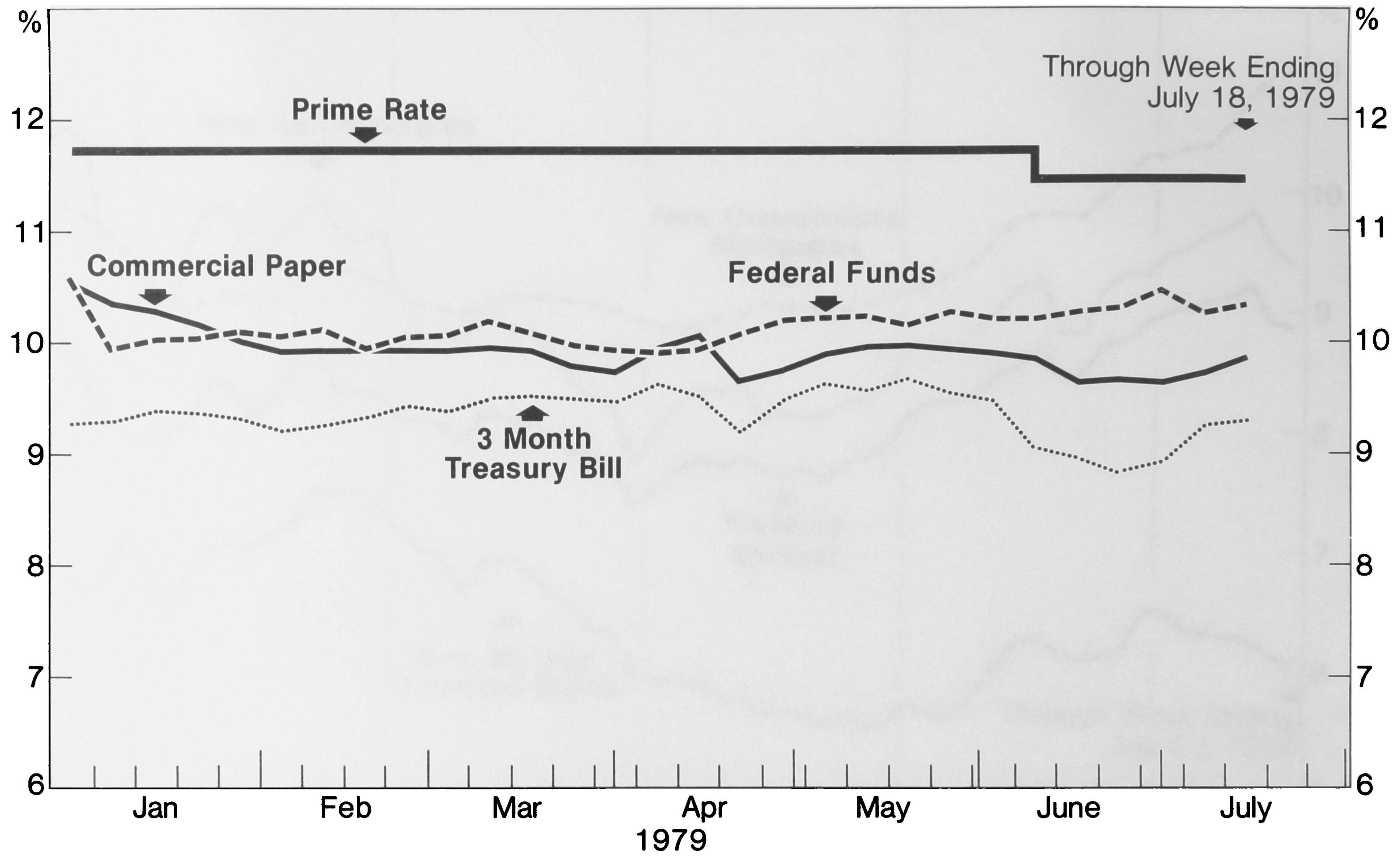
Office of Government Financing

July 24, 1979-4

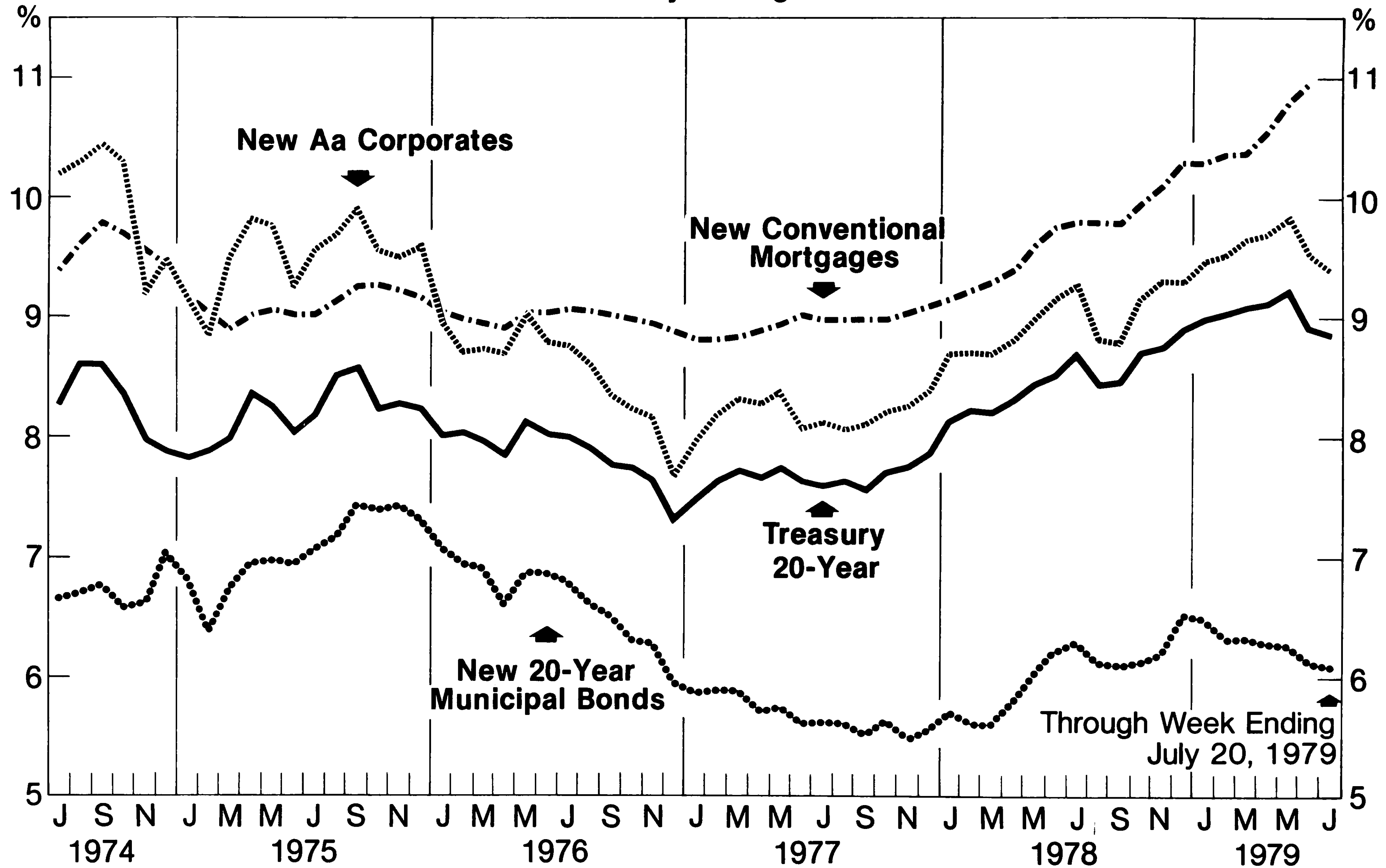
SHORT TERM INTEREST RATES

Weekly Averages



Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-7



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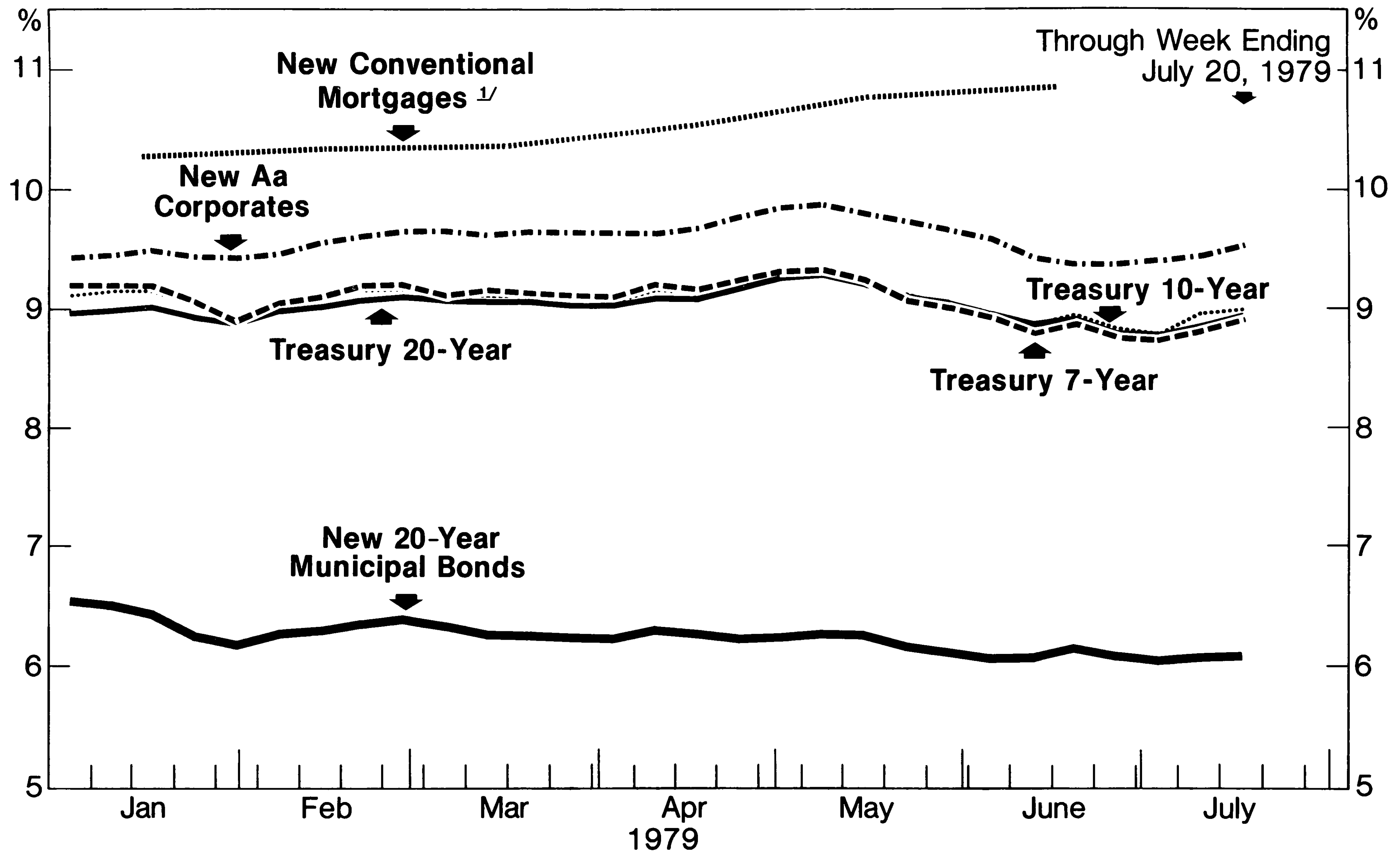
July 24, 1979-5

INTERMEDIATE AND LONG MARKET RATES

Weekly Averages



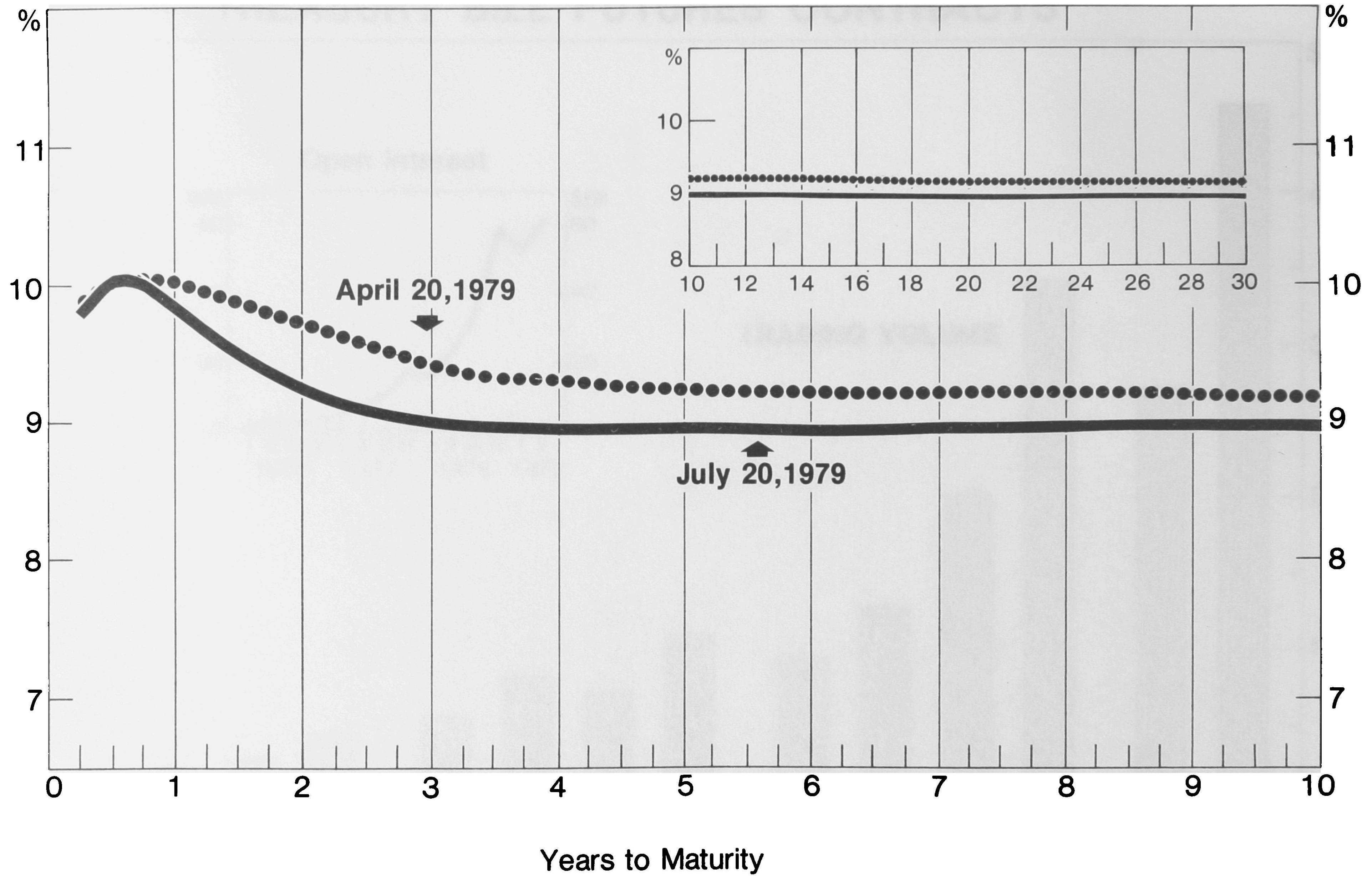
1/ Monthly, weekly data not available.

Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-8

MARKET YIELDS ON GOVERNMENTS

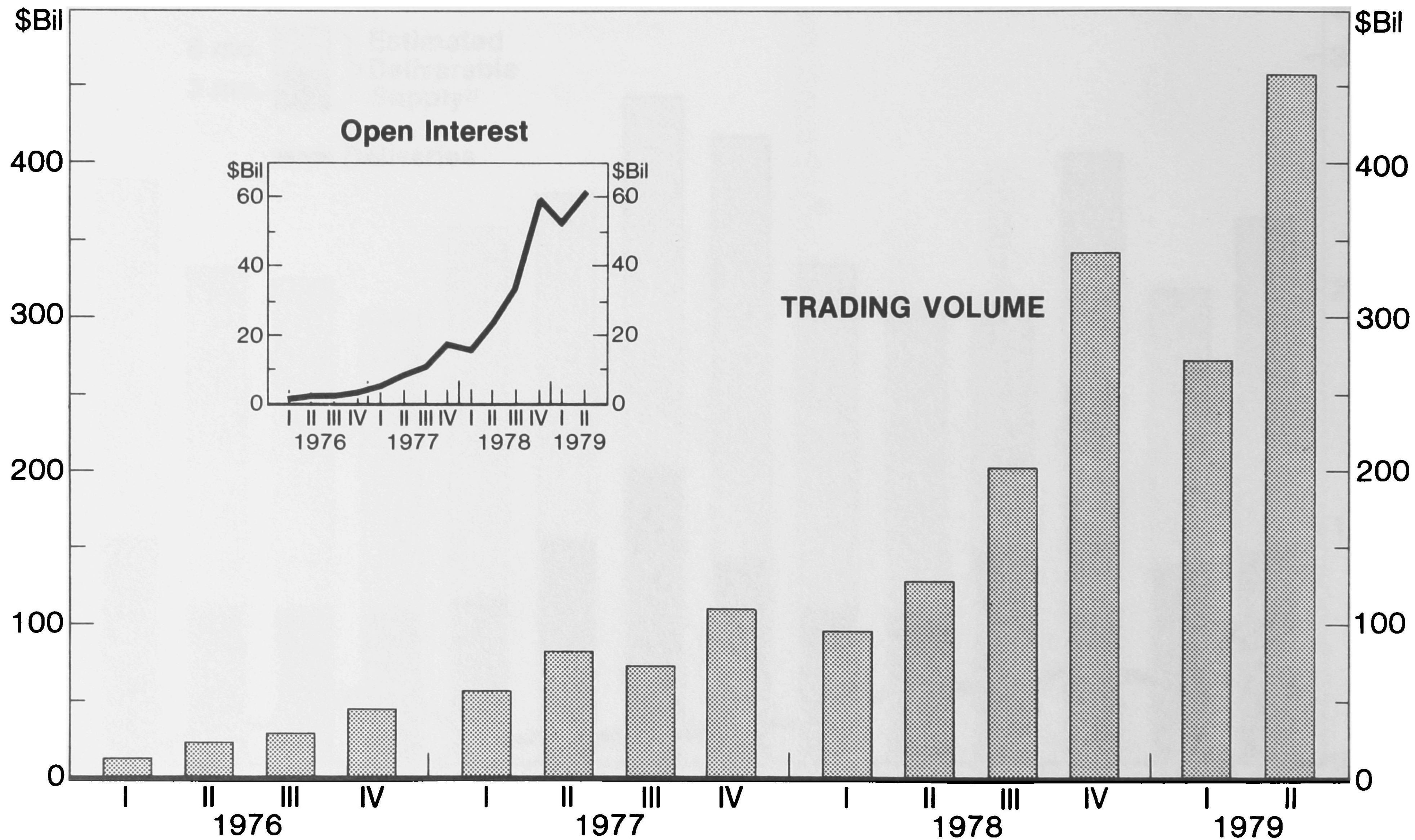
Bid Yields



Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-19

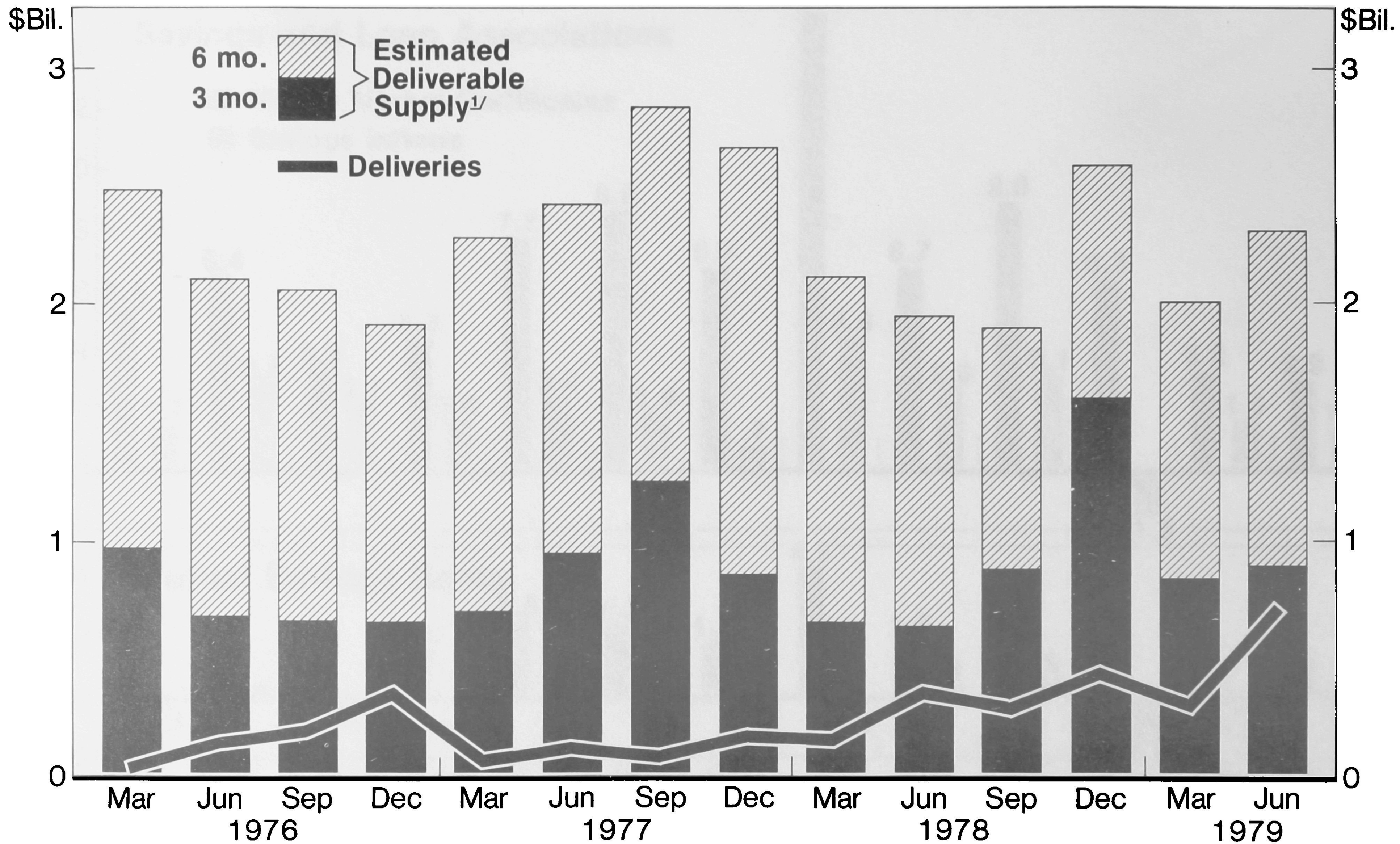
TRADING VOLUME AND OPEN INTEREST IN 90 DAY TREASURY BILL FUTURES CONTRACTS



Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-21

DELIVERABLE BILLS AND DELIVERIES ON 90 DAY TREASURY BILL FUTURES CONTRACTS

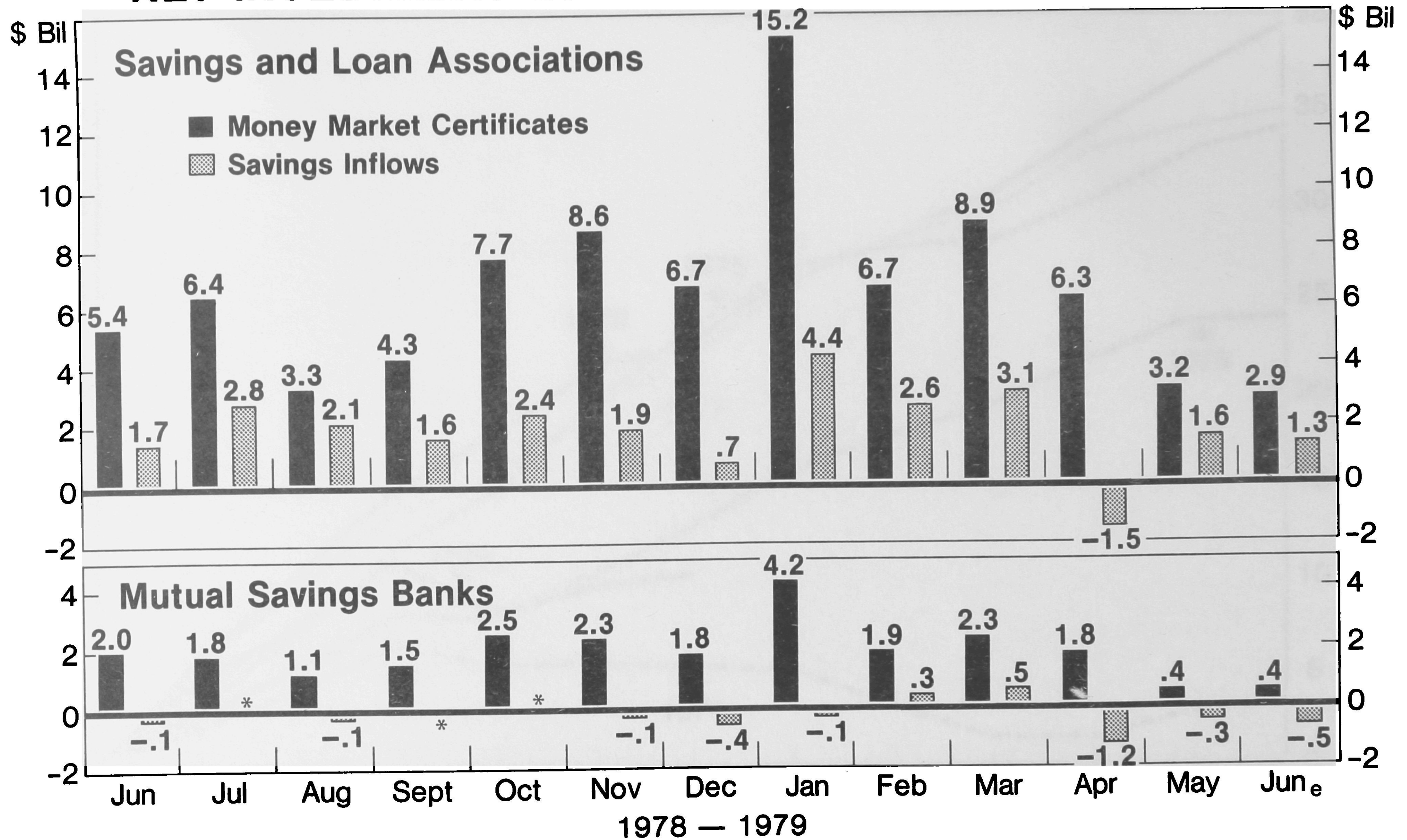


1/ Consists of the amount of accepted competitive tenders for the new 3 month bill and the 6 month bill issued 3 months earlier.

Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-22

NET SAVINGS INFLOWS (LESS INTEREST) AND NET INVESTMENT IN MONEY MARKET CERTIFICATES



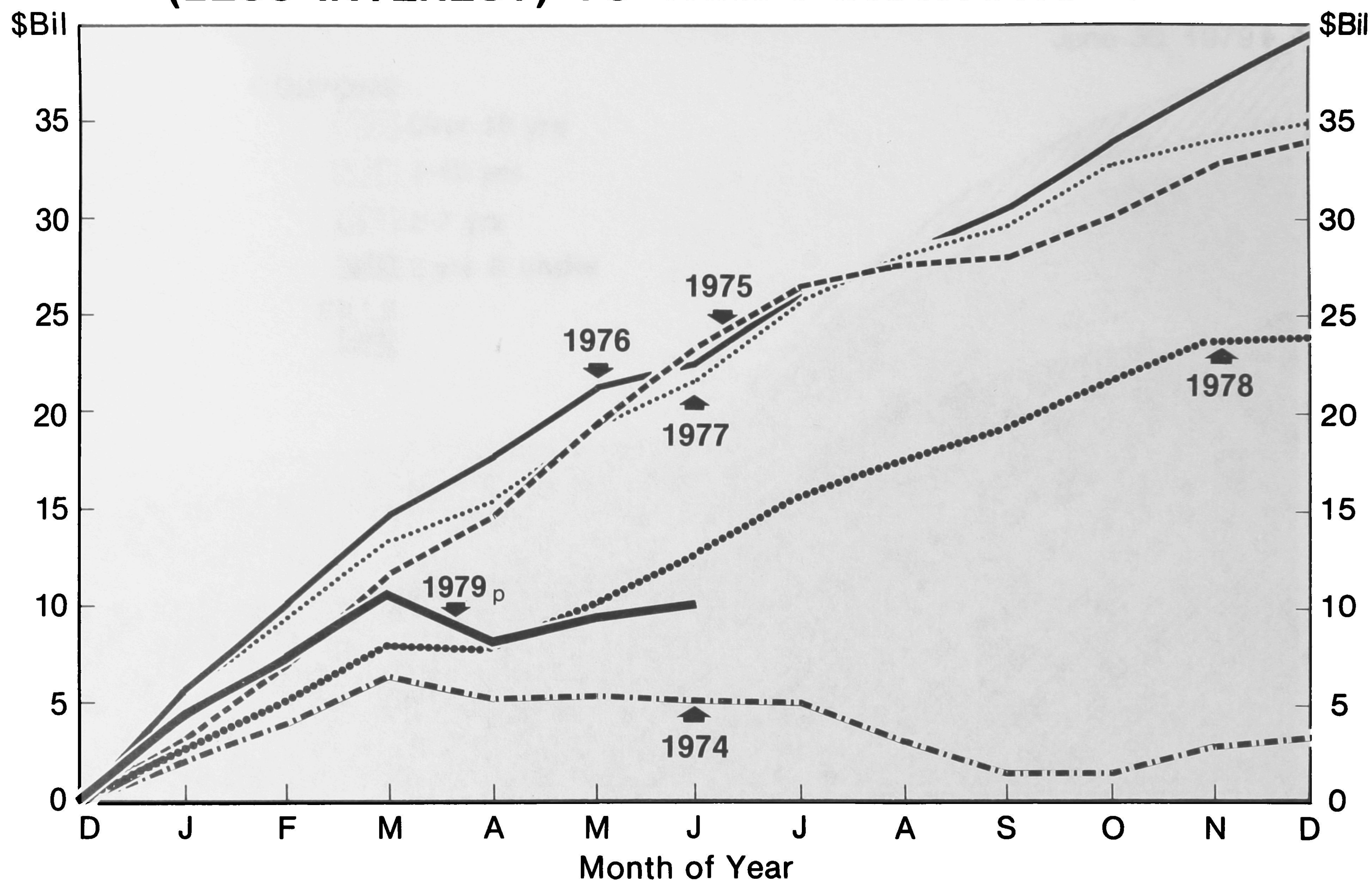
1978 — 1979

* Less than $50 million e estimated

Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-24

CUMULATIVE NET SAVINGS INFLOWS (LESS INTEREST) TO THRIFT INSTITUTIONS*

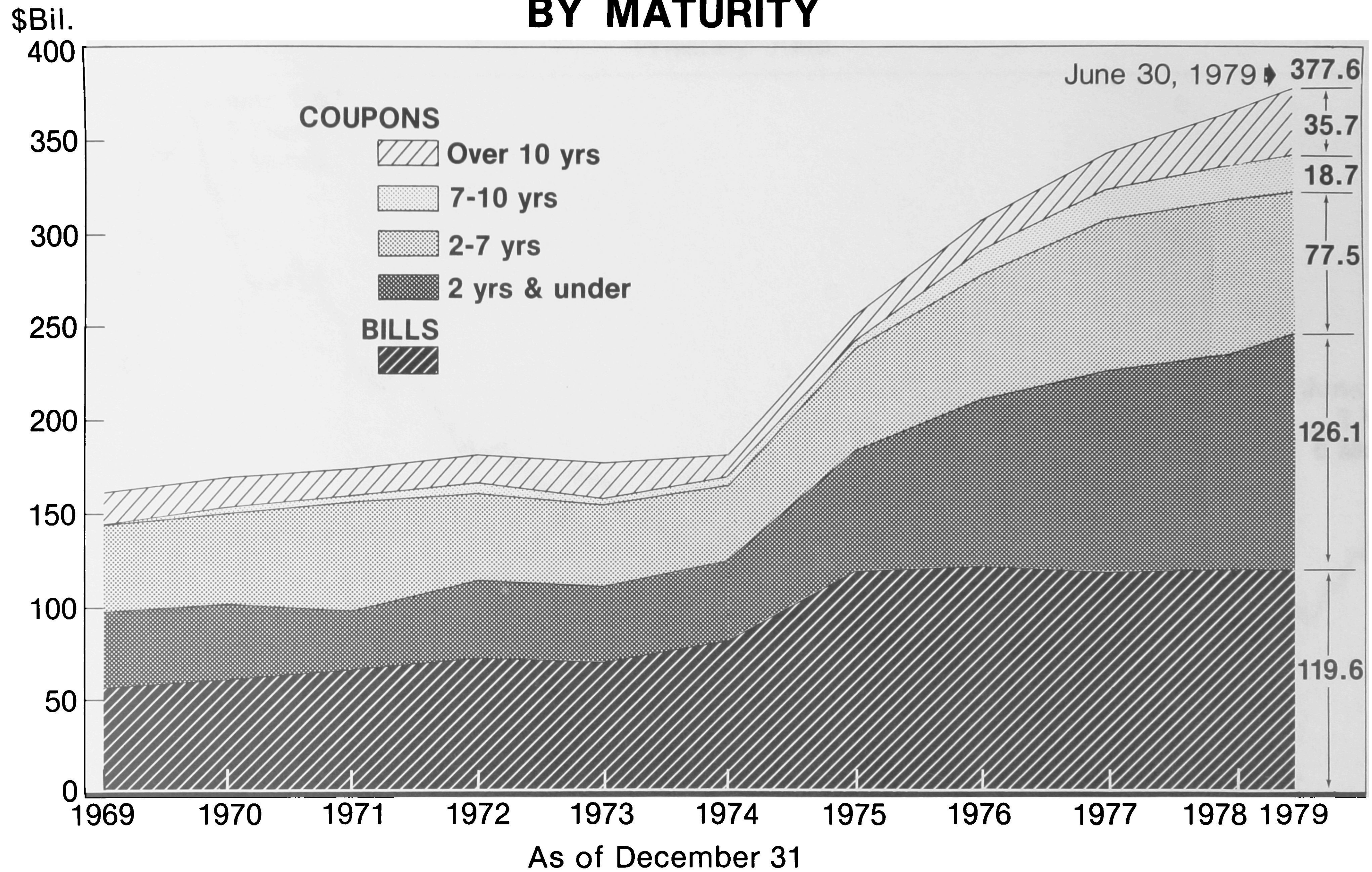


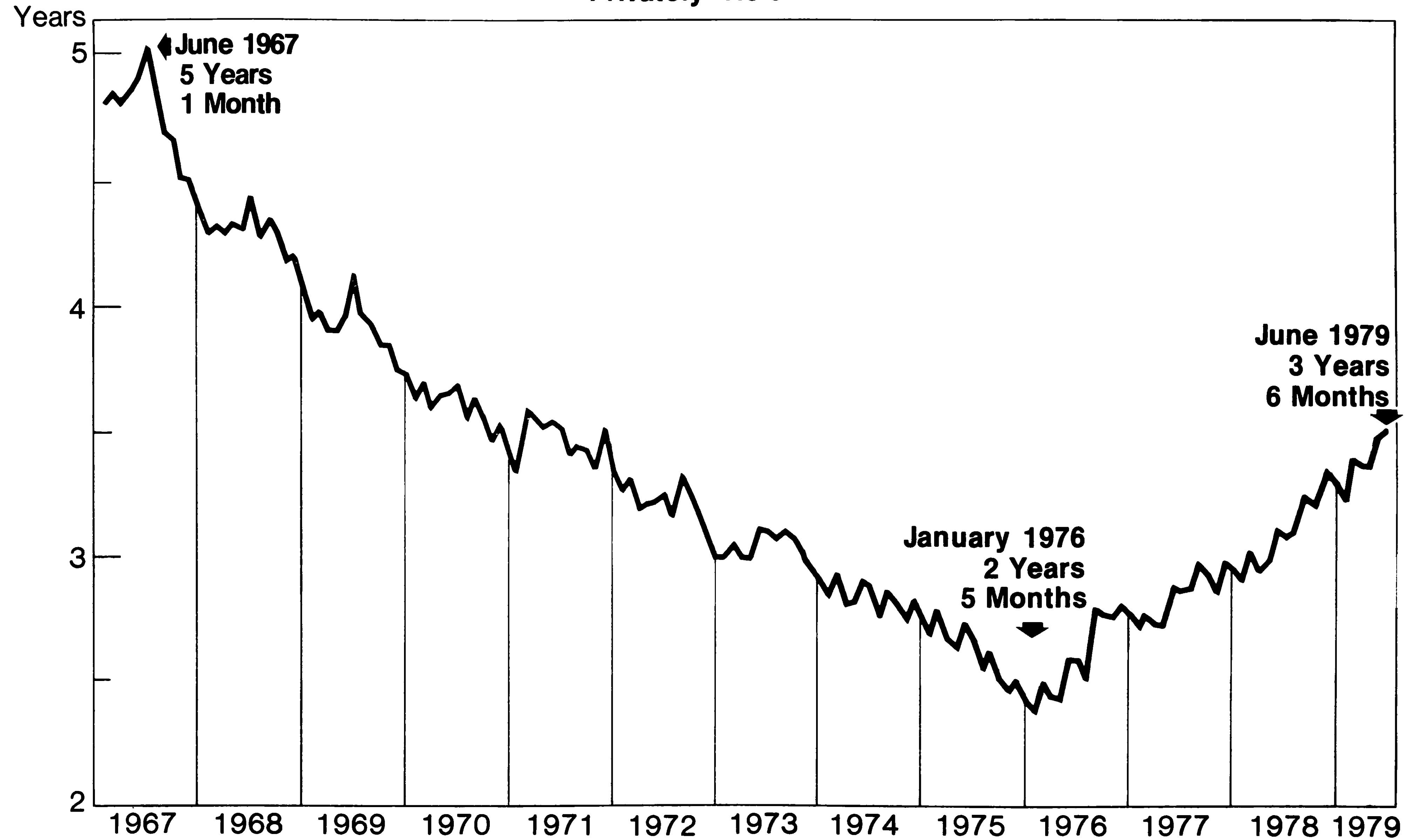
* Savings & Loan Assns. & Mutual Savings Banks.

p/ Preliminary

Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-18

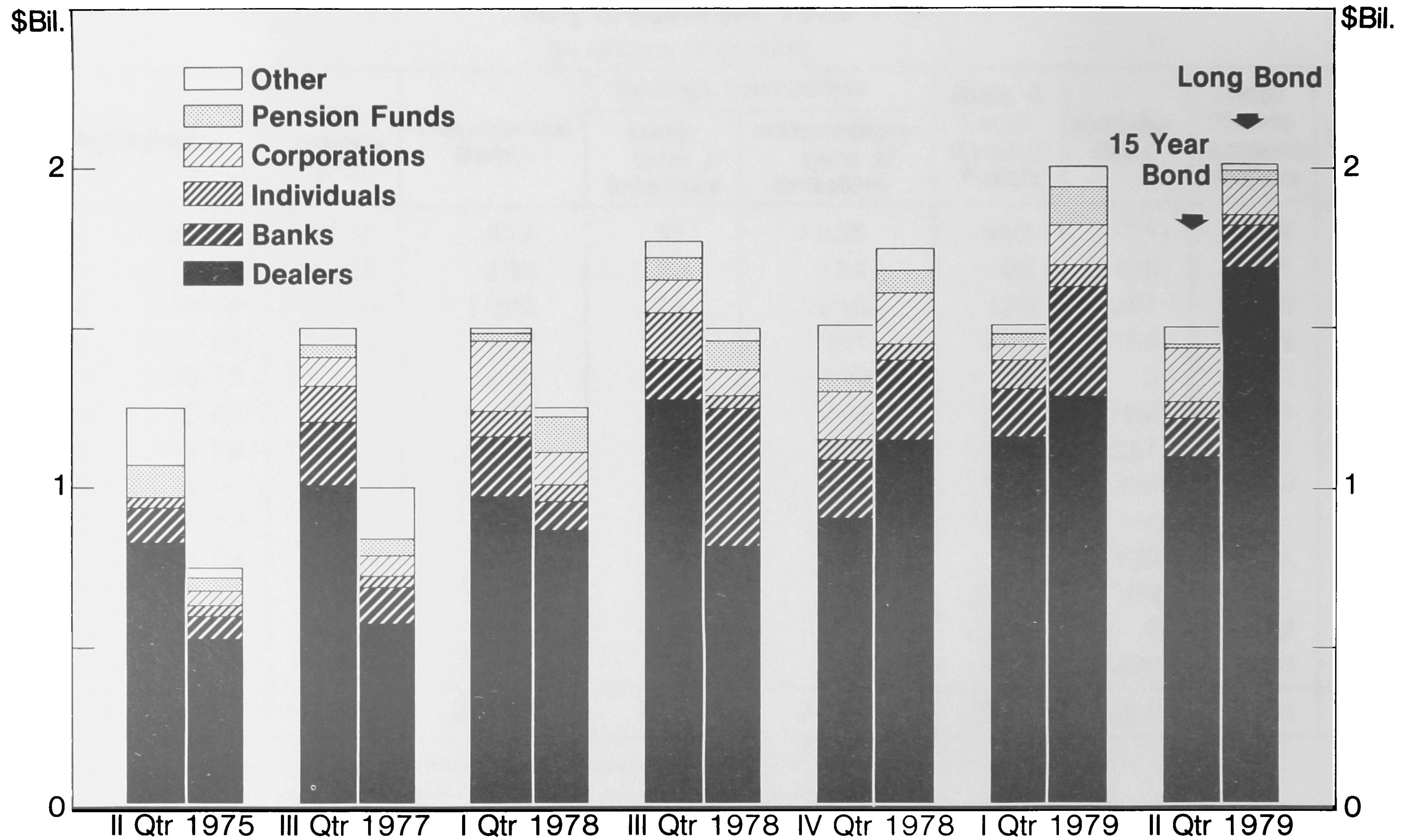

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT
BY MATURITY
$Bil.
400
350
300
250
200
150
100
50
0
June 30, 1979
377.6
35.7
18.7
77.5
126.1
119.6
COUPONS
Over 10 yrs
7-10 yrs
2-7 yrs
2 yrs & under
BILLS
1969
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
As of December 31



Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-1

ALLOTMENTS OF 15 YEAR AND LONG TREASURY BONDS



Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-23

OWNERSHIP OF MATURING COUPON ISSUES

July-December 1979*

(In Millions of Dollars)

Maturing Issues		Total Privately Held	Commercial Banks	Savings Institutions: Long-term 1/ Investors	Savings Institutions: Intermediate-term 2/ Investors	State & Local General Funds	Corpora-tions	Other Private Domestic Holders	Foreign
6 1/4% Nt.	7-31-79	3,021	817	39	235	469	174	369	918
6 1/4% Nt.	8-15-79	2,739	733	30	184	95	128	775	794
6 7/8% Nt.	8-15-79	2,109	1,035	23	218	120	291	59	363
6 5/8% Nt.	8-31-79	3,026	927	9	281	229	167	429	984
8 1/2% Nt.	9-30-79	1,851	623	48	199	51	2	806	122
6 5/8% Nt.	9-30-79	3,517	817	17	242	193	102	1,101	1,045
7 1/4% Nt.	10-31-79	3,877	1,156	44	269	175	257	681	1,295
6 1/4% Nt.	11-15-79	3,111	975	71	411	207	357	639	451
6 5/8% Nt.	11-15-79	461	175	1	63	31	—	191	—
7% Nt.	11-15-79	1,806	673	18	195	76	230	614	—
7 1/8% Nt.	11-30-79	4,308	1,293	37	364	382	359	544	1,329
7 1/2% Nt.	12-31-79	1,869	784	8	263	135	2	462	215
7 1/8% Nt.	12-31-79	3,352	977	88	243	422	239	585	798
Total		35,047	10,985	433	3,167	2,585	2,308	7,255	8,314

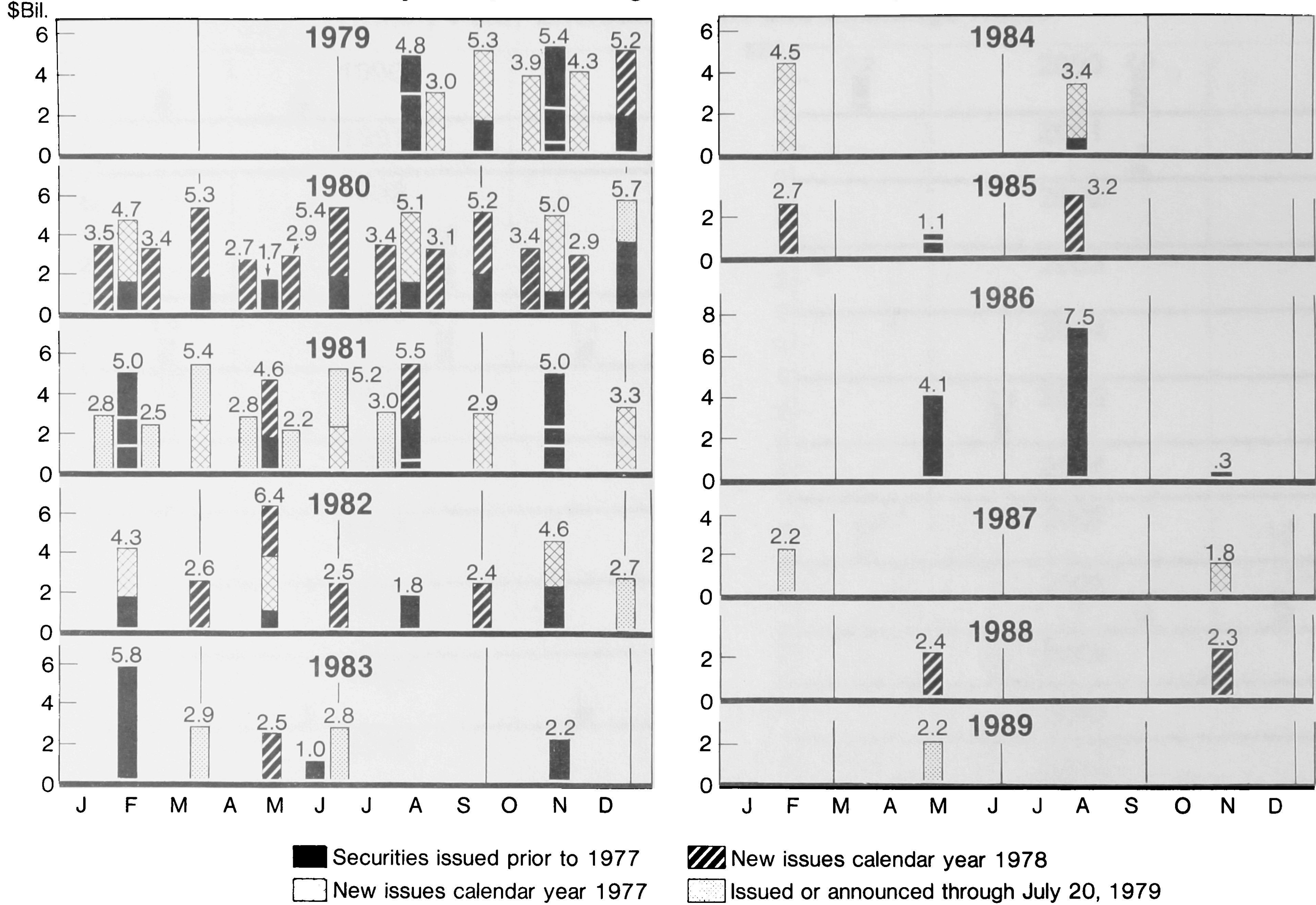
* Amounts for investor classes are based on the May 1979 Treasury Ownership Survey.

1/ Includes State and local pension funds and life insurance companies.

2/ Includes casualty and liability insurance companies, mutual savings banks, savings and loan associations, and corporate pension trust funds.

TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills and Exchange Notes

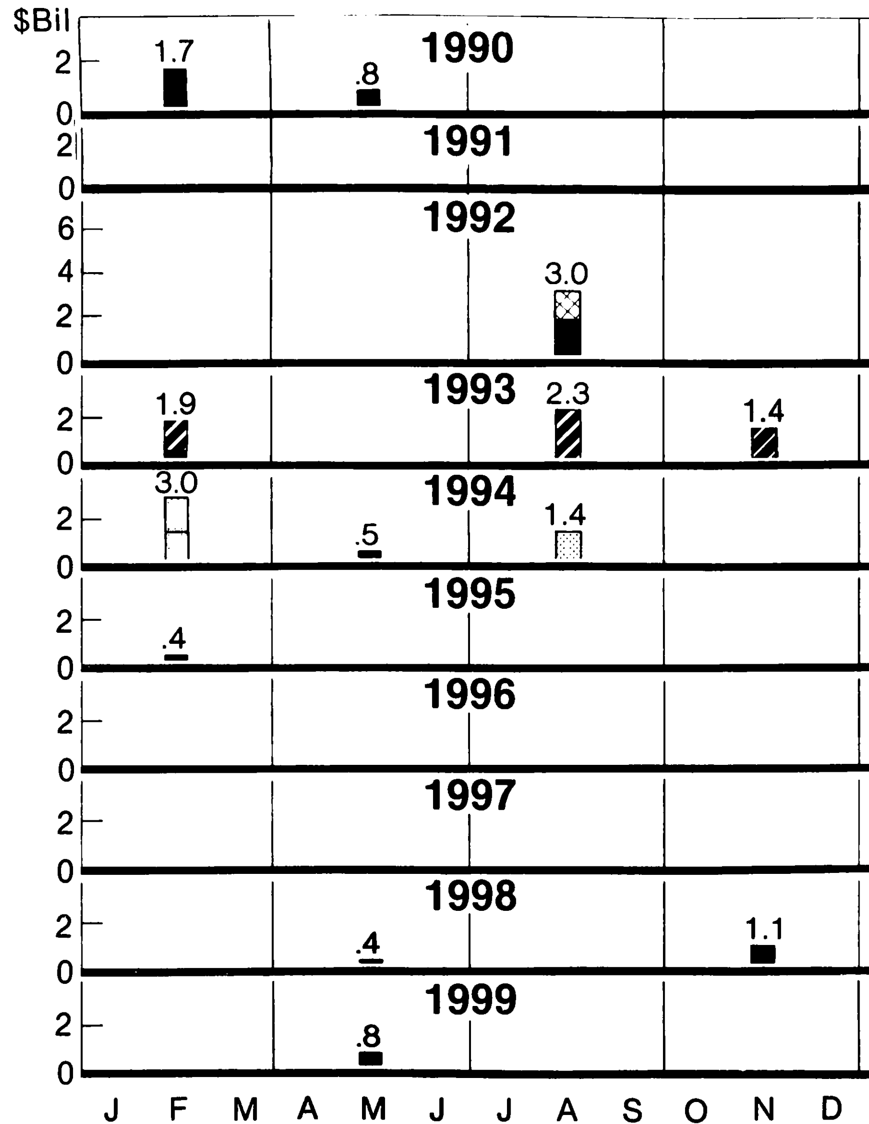


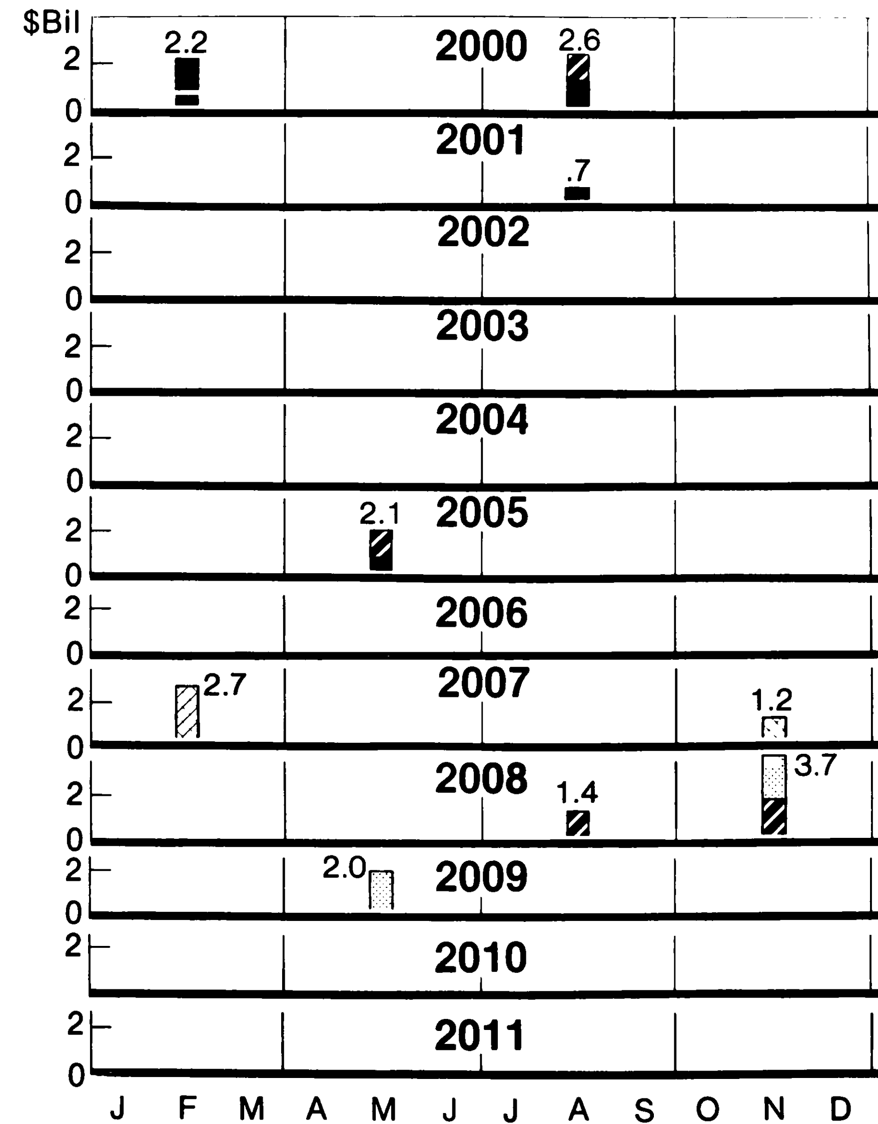
Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-10

TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills and Exchange Notes



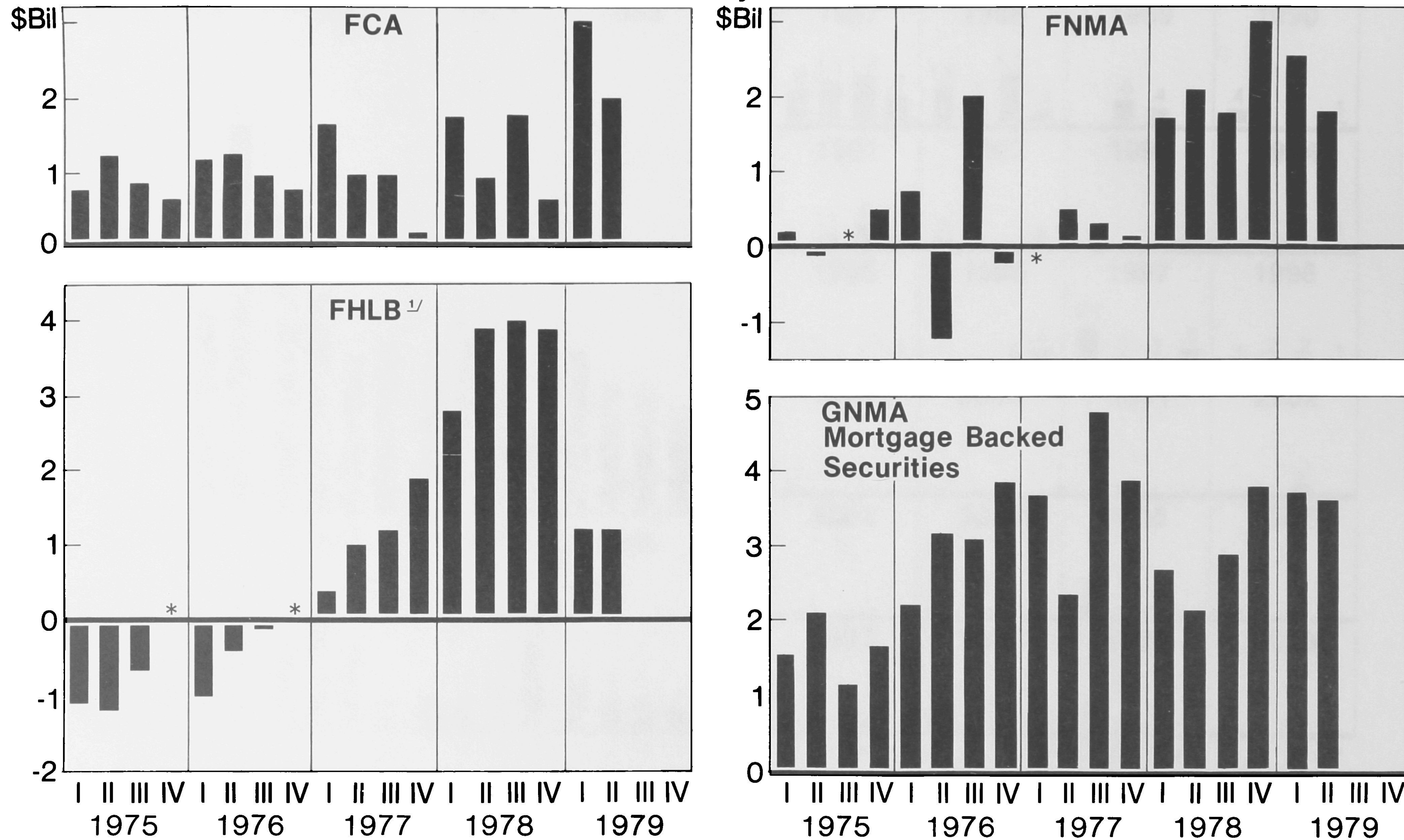


Securities issued prior to 1977
New issues calendar year 1977
New issues calendar year 1978
Issued or announced through July 20, 1979

Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-11

NET NEW MONEY IN AGENCY FINANCE, QUARTERLY
Privately Held



∗ Less than $50 million.

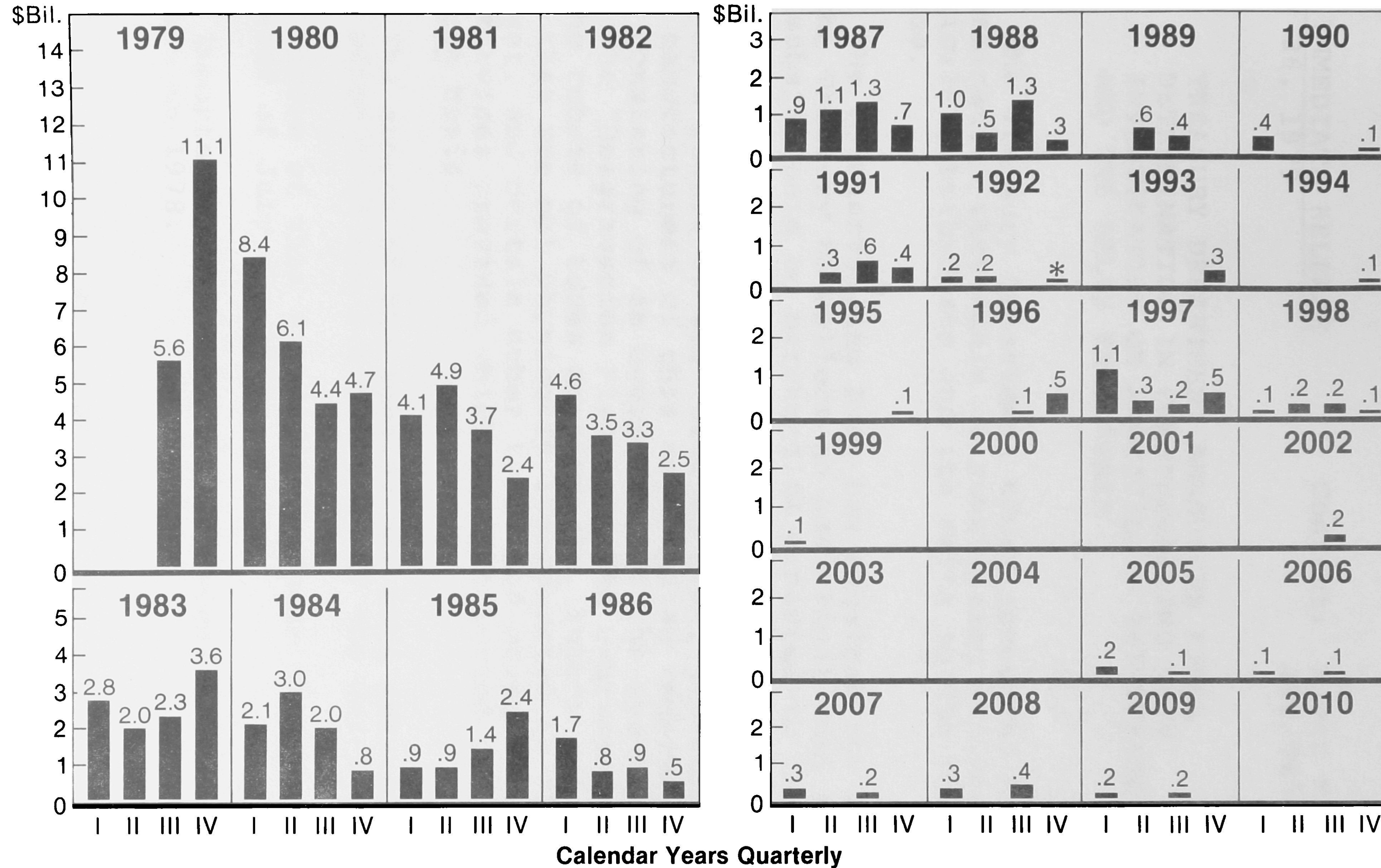
1/ Includes FHLB discount notes, bonds, and FHLMC certificates, mortgage-backed bonds, and mortgage participation certificates.

Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-14

AGENCY MATURITIES1/

Privately Held



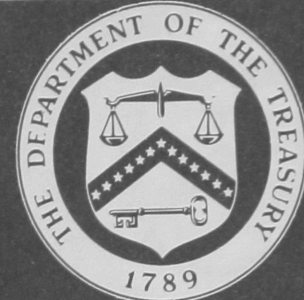
1/ Issued or announced through July 20, 1979.

* Less than $50 million.

Office of the Secretary of the Treasury
Office of Government Financing

July 24, 1979-16

artment of the TREASURY NEWS
INGTON, D.C. 20220 TELEPHONE 566-2041



FOR IMMEDIATE RELEASE
July 26, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY DEPARTMENT ANNOUNCES FINAL DETERMINATION IN COUNTERVAILING DUTY INVESTIGATION ON AMOXICILLIN TRIHYDRATE AND ITS SALTS FROM SPAIN

The Treasury Department today announced a final determination that Spain is subsidizing exports of amoxicillin trihydrate and its salts 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 an overrebate of the Spanish indirect tax, the "Desgravacion Fiscal." The overrebate consists of the rebate of taxes on services, inputs and ingredients that are not physically incorporated in the final product, and certain other taxes and charges assessed for services provided which are not levied on an *ad valorem* basis.

The amount of the subsidy has been determined to be 0.62 percent of the f.o.b. value of the merchandise.

Notice of this action will appear in the Federal Register of July 27, 1979

Imports of this merchandise amount to about $1.2-million in 1978.

o 0 o

B-1756

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

FOR IMMEDIATE RELEASE
July 27, 1979

Contact: George G. Ross
202/566-2356

UNITED STATES "MODEL" ESTATE AND GIFT TAX TREATY

The Treasury Department today released a revised "model" estate and gift tax treaty. The model represents the Treasury's basic treaty negotiating position. The new model, which replaces the model published by the Treasury Department on March 16, 1977, applies to the Federal taxes on transfers of estates and gifts and on generation-skipping transfers. Most of the revisions reflect the changes in Federal l[illegible] made by the Tax Reform Act of 1976.

The general principle underlying the model is to grant to the country of domicile the right to tax estates and transfers on a worldwide basis. The treaty also permits a credit for tax paid to the other country with respect to certain types of property on which tax was paid on the basis of the property's location. Specifically, transfers of real property and certain business assets are taxable in the country where they are situated. The model also allows the country of citizenship the right to tax the estate or transfers of a decedent or transferor, with a credit allowed for tax paid to the other State. The model also provides rules for resolving the issue of domicile.

The Treasury Department welcomes comments on the model. Comments should be sent in writing to: H. David Rosenbloom, International Tax Counsel, U. S. Treasury Department, Washington, D. C. 20220.

A copy of the model is attached. This notice appears in the Federal Register of July 31, 1979.

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B-1757

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MODEL OF JULY 9, 1979

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON ESTATES, INHERITANCES, GIFTS, AND GENERATION-SKIPPING TRANSFERS

The Government of the United States of America and the Government of , desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates, inheritances, gifts, and generation-skipping transfers, have agreed as follows:

July 9, 1979

Article 1

SCOPE

1. Except as otherwise provided in this Convention, this Convention shall apply to:

    a) transfers of estates of individuals whose domicile at their death was in one or both of the Contracting States;

    b) transfers of property by gift of donors whose domicile at the time of gift was in one or both of the Contracting States; and

    c) generation-skipping transfers of deemed transferors whose domicile at the time of deemed transfer was in one or both of the Contracting States.

2. This Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded:

    a) by the laws of either Contracting State; or

    b) by any other agreement between the Contracting States.

3. Notwithstanding any provision of this Convention except paragraph 4 of this Article, a Contracting State may tax transfers and deemed transfers of its domiciliaries (within the meaning of Article 4 (Fiscal Domicile)), and by reason of citizenship may tax transfers and deemed transfers of its citizens, as if this Convention had not come into effect. For this purpose the term "citizen" shall include a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of tax (including, for this purpose, income tax), but only for a period of 10 years following such loss.

4. The provisions of paragraph 3 shall not affect:

   a) the benefits conferred by a Contracting State under Articles 11 (Credits), 12 (Non-Discrimination), and 13 (Mutual Agreement Procedure); and

   b) the benefits conferred by a Contracting State under Article 15 (Diplomatic Agents and Consular Officers) upon individuals who are neither citizens of, nor have permanent residence in, that State.

July 9, 1979

Article 2

TAXES COVERED

1. The taxes to which this Convention applies are:

   a) In the United States: the Federal estate tax; the Federal gift tax; and the Federal tax on generation-skipping transfers.

   b) In ______________ :________________________________

   ____.

2. This Convention shall apply also to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws and shall notify each other of any official published material concerning the application of this Convention, including explanations, regulations, rulings, and judicial decisions.

3. For the purpose of Article 12 (Non-Discrimination), this Convention shall also apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof. For the purpose of Article 14 (Exchange of Information), this Convention shall also apply to taxes of every kind imposed by a Contracting State.

July 9, 1979

Article 3

GENERAL DEFINITIONS

1. For the purpose of this Convention, unless the context otherwise requires:

a) the term "United States" means the United States of America and, where used in a geographical sense, includes any area outside the territorial sea of the United States which, in accordance with international law and the laws of the United States, has been or may hereafter be designated as an area within which the United States may exercise rights with respect to the exploration and exploitation of the natural resources of the seabed or its subsoil; the term "United States" does not include Puerto Rico, the Virgin Islands, Guam, or any other United States possession.

b) the term " " means ________________ .

c) the terms "Contracting State" and "the other Contracting State" mean the United States or ___________ ,as the context requires.

d) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean, respectively, an industrial or commercial activity carried on by a domiciliary of a Contracting State and an industrial or commercial activity carried on by a domiciliary of the other Contracting State.

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

f) the term "nationals" means:

   i) all individuals possessing the citizenship of a Contracting State;

   ii) all legal persons, partnerships, and associations deriving their status as such from the laws in force in a Contracting State.

g) the term "competent authority" means:

i) in the United States: the Secretary of the Treasury or his delegate, and

ii) in __________ : ______________________________ .

2. As regards the application of this Convention by a Contracting State, any term not defined therein shall, unless the context otherwise requires and subject to the provisions of Article 13 (Mutal Agreement Procedure), have the meaning which it has under the laws of that State concerning the taxes to which this Convention applies.

July 9, 1979

Article 4

FISCAL DOMICILE

1. For the purposes of this Convention, an individual has a domicile:

   a) in the United States, if he is a resident or citizen thereof under United States law;

   b) in ____________, if ____________________________.

2. Where by reason of the provisions of paragraph 1 an individual was domiciled in both Contracting States, then, subject to the provisions of paragraph 3, his status shall be determined as follows:

   a) the individual shall be deemed to have been domiciled in the State in which he had a permanent home available; if such individual had a permanent home available in both States, he shall be deemed to have been domiciled in the State with which his personal and economic relations were closer (center of vital interests);

b) if the State in which the individual's center of vital interests was closer cannot be determined, or if he had no permanent home available in either State, he shall be deemed to have been domiciled in the State in which he had an habitual abode;

c) if the individual had an habitual abode in both States or in neither of them, the domicile shall be deemed to be in the State of which he was a citizen;

d) if the individual was a citizen of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where an individual was

a) a citizen of one Contracting State, but not the other Contracting State,

b) within the meaning of paragraph 1 domiciled in both Contracting States, and

c) within the meaning of paragraph 1 domiciled in the other Contracting State in the aggregate less than 7 years (including periods of temporary absence) during the preceding 10-year period,

then the domicile of that individual shall be deemed, notwithstanding the provisions of paragraph 2, to have been in the Contracting State of which the individual was a citizen.

4. An individual who, at the time of his death or the making of a gift or deemed transfer, was a resident of a possession of the United States and who had become a citizen of the United States solely by reason of (a) being a citizen of a possession, or (b) birth or residence within a possession, shall be considered as having been neither domiciled in nor a citizen of the United States at that time for the purposes of this Convention.

5. For the purposes of this Convention the question whether a person other than an individual was domiciled in a Contracting State shall be determined according to the law of that State. Where such person is determined to have been domiciled in both Contracting States, the competent authorities of the Contracting States shall settle the question by mutual agreement.

July 9, 1979

Article 5

REAL PROPERTY

1. Transfers and deemed transfers of real property from an individual domiciled in a Contracting State and which is situated in the other Contracting State may be taxed in that other State.

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

July 9, 1979

Article 6

BUSINESS PROPERTY OF A PERMANENT ESTABLISHMENT AND ASSETS PERTAINING TO A FIXED BASE USED FOR THE PERFORMANCE OF INDEPENDENT PERSONAL SERVICES

1. Except for assets referred to in Articles 5 (Real Property) and 7 (Ships and Aircraft), transfers and deemed transfers of assets from an individual domiciled in a Contracting State, forming part of the business property of a permanent establishment situated in the other Contracting State, may be taxed in that other State.

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

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

   a) a branch;

   b) an office;

   c) a factory;

   d) a workshop; and

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

4. A building site or construction or installation project, or an installation or drilling rig or ship being used for the exploration or development of natural resources, constitutes a permanent establishment in a Contracting State only if it has remained in that State more than 24 months.

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

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

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

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

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

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

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

6. Notwithstanding the provisions of paragraphs 2 and 3, where a person -- other than an agent of an independent status to whom paragraph 7 applies -- is acting on behalf of an enterprise and has and habitually exercises in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 5 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

7. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general

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

8. Except for assets described in Articles 5 (Real Property) and 7 (Ships and Aircraft), transfers and deemed transfers of assets from an individual domiciled in a Contracting State, pertaining to a fixed base situated in the other Contracting State and used for the performance of independent personal services, may be taxed in that other State.

July 9, 1979

Article 7

SHIPS AND AIRCRAFT

Notwithstanding Article 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services), transfers and deemed transfers of ships and aircraft operated in international traffic from a domiciliary of a Contracting State, and of movable property pertaining to the operation of such ships and aircraft, including containers, shall be taxable only in that State.

July 9, 1979

Article 8

INTERESTS IN PARTNERSHIPS

Transfers and deemed transfers, from a domiciliary of a Contracting State, of an interest in a partnership which owns property covered by Articles 5 (Real Property) or 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services) situated in the other Contracting State may be taxed in that other State, but only to the extent that the value of such interest is attributable to such property.

July 9, 1979

Article 9

PROPERTY NOT EXPRESSLY MENTIONED

Transfers and deemed transfers of property other than property referred to in Articles 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services), 7 (Ships and Aircraft), and 8 (Interests in Partnerships,) from a domiciliary of a Contracting State, shall be taxable only in that State.

July 9, 1979

Article 10

DEDUCTIONS AND EXEMPTIONS

1. Debts that would be deductible according to the internal law of a Contracting State shall be deducted from the gross value of the property the transfer of which may be taxed by that State in the proportion that such gross value bears to the gross value of the entire transferred property wherever situated.

2. The value of property transferred which may be taxed by a Contracting State shall be reduced by the amount of any debts of the transferor or deemed transferor assumed by the transferee or deemed transferee, other than debts allowed as a deduction under paragraph 1.

3. The transfer or deemed transfer of property to or for the use of a corporation or organization of one Contracting State organized and operated exclusively for religious, charitable, scientific, literary or educational purposes shall be exempt from tax by the other Contracting State, if and to the extent that such transfer

a) is exempt from tax in the first-mentioned Contracting State; and

b) would be exempt from tax in the other Contracting State if it were made to a similar corporation or organization of that other State.

4. The tax of a Contracting State with respect to the transfer of property (other than community property) which is transferred from a domiciliary or citizen of the other Contracting State to his or her spouse shall be determined as follows:

a) in the case of tax imposed by ___________, such property shall be included in the taxable base only to the extent that the value of the property exceeds 50 percent of the value of all property (after taking into account any applicable deductions) whose transfer may, under this Convention, be taxed by _______;

b) in the case of tax imposed by the United States, the tax shall be limited to the amount of tax that would have been imposed if the transferor were a domiciliary of the United States.

5. Where a Contracting State may tax the transfer of an estate solely by reason of Articles 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services), or 8 (Interests in Partnerships), that State shall allow a credit against its tax, in addition to any other credits that may be allowed under Article 11 (Credits), in an amount no less than $3,600, or shall allow an equivalent exemption in computing the tax otherwise due.

July 9, 1979

Article 11

CREDITS

1. Where the United States imposes tax by reason of an individual's domicile therein or citizenship thereof, double taxation shall be avoided in the following manner:

a) where ______________ imposes tax with respect to a transfer or deemed transfer of property in accordance with Articles 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services), or 8 (Interests in Partnerships), the United States shall allow as a credit against the tax calculated according to its law with respect to such transfer or deemed transfer an amount equal to the tax paid to __________ with respect to such transfer or deemed transfer.

b) if the individual was a citizen of the United States and was domiciled in ________________ at the date of his death, gift, or deemed transfer, then the United States shall allow as a credit against the tax calculated according

to its law with respect to the transfer or deemed transfer of property (other than property whose transfer or deemed transfer the United States may tax in accordance with Articles 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services), or 8 (Interests in Partnerships)), an amount eaual to the tax paid to __________ with respect to such transfer or deemed transfer. This subparagraph shall not apply to a former United States citizen whose loss of citizenship had as one of its principal purposes the avoidance of United States tax (including, for this purpose, income tax).

2. Where ________________ imposes tax by reason of an individual's domicile therein or citizenship thereof, double taxation shall be avoided in the following manner:

a) where the United States imposes tax with respect to the transfer or deemed transfer of property in accordance with Articles 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed

Base Used for the Performance of Independent Personal Services), or 8 (Interests in Partnerships), ________________ shall allow as a credit against the tax calculated according to its law with respect to such transfer or deemed transfer an amount equal to the tax paid to the United States with respect to such transfer or deemed transfer.

b) if the individual was domiciled in the United States at the date of his death, gift, or deemed transfer, then __________________ shall allow as a credit against the tax calculated according to its law with respect to the transfer or deemed transfer of property (other than property which ______________ may tax in accordance with Articles 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services), or 8 (Interests in Partnerships)), an amount equal to the amount of the tax paid to the United States with respect to such transfer or deemed transfer.

3. If a Contracting State imposes tax upon the transfer of an estate, the credit allowed by paragraph 1 or 2 shall include credit for any tax imposed by the other Contracting State upon a prior gift of property made by, or a prior generation-skipping transfer of property deemed made by, the decedent, if the transfer of such property is subject to tax on the transfer of the estate imposed by the first-mentioned State.

4. The credit allowed by a Contracting State under paragraph 1 or 2 shall not be reduced by any credit allowed by the other Contracting State for taxes paid upon prior transfers or deemed transfers.

5. The credit allowed by a Contracting State according to the provisions of paragraphs 1, 2, 3, and 4 shall include credit for taxes paid to political subdivisions of the other Contracting State to the extent that such taxes are allowed as credits by that other State.

6. Any credit allowed under paragraphs 1 and 2 shall not exceed the part of the tax of a Contracting State, as computed before the credit is given, which is attributable to the transfer or deemed transfer of property in respect of which a credit is allowable under such paragraphs.

7. Any claim for credit or for refund of tax founded on the provisions of this Article may be made until two years after the final determination (administrative or judicial) and payment of tax for which any credit under this Article is claimed, provided that the determination and payment are made within ten years of the date of death, gift, or deemed transfer. The competent authorities may by mutual agreement extend the ten year time limit if circumstances prevent the determination within such period of the taxes which are the subject of the claim for credit. Any refund based solely on the provisions of this Convention shall be made without payment of interest on the amount so refunded.

July 9, 1979

Article 12

NON-DISCRIMINATION

1. Citizens of a Contracting State shall not be subjected in the other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which citizens of that other State in the same circumstances are or may be subjected. This provision shall also apply to persons who are not domiciliaries of a Contracting State. However, for purposes of United States taxation of transfers and deemed transfers, United States citizens not domiciled in the United States are not in the same circumstances as citizens of _____________ not domiciled in the United States.

2. The taxation with respect to a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied with respect to enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs, and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

3. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

4. The provisions of this Article shall apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

July 9, 1979

Article 13

MUTUAL AGREEMENT PROCEDURE

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic laws of those States, present his case to the competent authority of the Contracting State of which he is a resident or national. Such presentation must be made within one year after a claim, under this Convention, for exemption, credit, or refund has been finally settled or rejected.

2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or

application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

5. The competent authorities of the Contracting States may prescribe regulations to carry out the purposes of this Convention.

July 9, 1979

Article 14

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning the taxes covered by the Convention insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Article 1 (Scope). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State; or

c) to supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

3. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain the information to which the request relates in the same manner and to the same extent as if the tax of the first-mentioned State were the tax of that other State and were being imposed by that other State. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of

depositons of witnessess and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, or writings), to the same extent such depositions in documents can be obtained under the laws and administrative practices of such other State with respect to its own taxes.

4. For the purpose of this Article, this Convention shall apply to taxes of every kind imposed by a Contracting State.

July 9, 1979

Article 15

DIPLOMATIC AGENTS AND CONSULAR OFFICERS

1. Nothing in this Convention shall affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or under the provisions of special agreements.
2. This Convention shall not apply to officials of international organizations or members of a diplomatic or consular mission of a third State, who were established in a Contracting State and were not treated as being domiciled in either Contracting State in respect of taxes on estates, inheritances, gifts, or generation-skipping transfers as the case may be.

July 9, 1979

Article 16

ENTRY INTO FORCE

1. This Convention shall be subject to ratification in accordance with the applicable procedures of each Contracting State and instruments of ratification shall be exchanged at ________________ as soon as possible.

2. This Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall apply to transfers of estates of individuals dying, gifts made, and generation-skipping transfers deemed made on or after the date of such exchange.

July 9, 1979

Article 17

TERMINATION

This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention at any time after 5 years from the date on which this Convention enters into force provided that at least 6 months' prior notice of termination has been given through diplomatic channels. In such event, the Convention shall have no effect in respect of transfers of estates of individuals dying, gifts made, and deemed transfers occurring after the December 31 next following the date of termination specified in the notice of termination.

July 9, 1979

DONE at ______________________________ , in duplicate, in the English and ________ languages, the two texts having equal authenticity, this ____________ day of ______ , 19 .

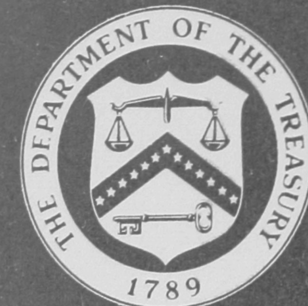
For the United States of America:

(Seal) ____

For

(Seal) ____

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



For Release Upon Delivery
Expected at 9:00 p.m. E.D.T.

STATEMENT OF HARRY L. GUTMAN
DEPUTY TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON SELECT REVENUE MEASURES
July 27, 1979

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear today to present the views of the Treasury Department on the subject of the simplification of the tax laws generally, and on specific proposals for simplification and other miscellaneous measures.

B-1758

SIMPLIFICATION

The Treasury Department views simplification as a fundamental policy objective, for the cost of tax complexity is enormous. A portion of the cost is tangible; taxpayers and the Government devote billions of dollars to the effort to decipher the tax Code. But a more significant cost is intangible; if we permit the Byzantine tax complexity to grow, we erode the foundation of our tax structure. A self-assessment system is severely impaired when the tax treatment of even routine transactions can be incomprehensible to most taxpayers and require professional advice for compliance.

Occasionally, sweeping reforms have been proposed as antidotes to tax complexity. Some persons have advocated a fresh start in developing a new income tax system, coupling lower tax rates with a substantial reduction in complicating provisions that refine the concept of taxable income. Others have offered a new kind of tax -- perhaps on consumption or value added -- as an alternative that might be simpler in operation than the current income tax. Such proposals should continue to be developed and debated, but drastic simplication along these lines is at best a long-term objective. In the short run, incremental simplification steps must be pursued. We applaud the Chairman for commencing this process with the Subcommittee's consideration today of H.R. 3899 and H.R. 3900.

In recent years, most persons have acknowledged the need for simplification of the tax law. Yet, in spite of the apparent consensus in favor of simplification, enactment of specific proposals will not be easy. Our mission will surely fail if the cloak of "simplification" is used to disguise other motives. For some practitioners, simplicity seems to be a code word for eliminating any impediments to the tax results sought for particular clients. Discussions at simplification conferences sometimes suggest that no law reducing taxes is too complex and no law increasing taxes is simple enough. Of course, on the other hand, some would accuse the Treasury of seeking revenue-raising tax reform by calling it "tax simplification."

In this endeavor, we must all strive to avoid our natural biases. With the proper exercise of good will, this simplification effort can succeed. If either side refuses to compromise, it is doomed to failure.

Sometimes, the search for equity can also be an obstacle to simplicity. Simplicity is impossible if we become too preoccupied with avoiding unwarranted advantages or disadvantages that may result from peculiar fact situations. Equity is of paramount importance, but a ton of complexity is a high price to pay for an ounce of equity. Treasury and taxpayers must be willing to suppress the drive for complete equity, submerging this goal to simplicity when the additional equity comes at too high a cost.

In this regard, H.R. 3899 -- the bill to revise the tax treatment of sales for deferred payment -- will be an important barometer of the fortunes of the simplification effort. Taxation of deferred payment sales is generally recognized to be an area where complexity, and in particular diversity of treatment, exists beyond any reasonable needs of tax policy. Nevertheless, even here there will be trade offs; no simple rule for treatment of sales for contingent payments can possibly satisfy everyone as being equitable in all circumstances.

The avoidance of new complications, such as those contained in H.R. 2770, the Independent Local Newspaper Act, is as important as affirmative steps to simplify existing law. A proper balance of simplicity and equity should discourage much legislation, particularly tax measures affecting only a handful of taxpayers. Because of the broad application of the tax laws to diverse personal, charitable and business sectors of our society, it is important that a vehicle exist to consider whether an unintended tax liability has arisen. But regardless of how we resolve the equitable merits of particular legislation, we must recognize that _ad hoc_ solutions inevitably increase the complexity of the Code, invite other taxpayers to seek similar relief and, unless scrupulously drafted, create new potentials for abuse.

Complications caused by special interest bills must be weighed against the equity in the claim for relief. Unless the equitable argument is extremely strong, the claim should be rejected. We certainly do not feel that taxpayers should be encouraged to view the legislative process as a forum of first, rather than last, resort. Often it is possible, with minor changes of behavior, to accommodate taxpayer activities to the current provisions of the Code. If this can be done, legislative relief is not needed. We hope the professional tax community can join with the Treasury in opposing the proliferation of special interest tax legislation, which in itself complicates the law and takes time away from more far-reaching and important efforts.

I have thus far dealt principally with simplification of the mecnanics of the tax law. I must, however, touch also upon a more fundamental cause of concern. No discussion of tax simplification should overlook the prime source of complexity: the use of the tax system to perform far too many Government functions. The basic purpose of the income tax system is to raise revenue by applying a rate structure to a tax base consisting of "net income." But it is also used to implement nearly 100 Federal programs, ranging from welfare assistance to promotion of certain forms of investment. These so-called "tax expenditures" are nearly one-third as large as direct budget outlays. As long as we insist upon combining the basic revenue-raising function with a plethora of tax expenditures, we cannot expect the tax Code to be simple.

Nevertheless, technical tax simplification is important, and I would like to express again our endorsement of the simplificaton process this Subcommittee has set out to implement. Dramatic improvements cannot be achieved overnight. Time will be needed for Congressional and Treasury staffs and for tax practitioners to develop and to analyze additional proposals. Unless serious Congressional consideration is relatively assured, we cannot expect the professional tax community or the staffs to expend the necessary resources. For this reason, the Subcommittee's expression of interest and support for simplification is most welcome. Mr. Chairman, we are grateful for the leadership you have taken in this effort.

SIMPLIFICATION PROPOSALS
H.R. 3899 -- DEFERRED PAYMENT SALES

The installment sale area is an excellent choice for beginning what we hope will become an ongoing simplification process.

I. Current Law

The current law applicable to reporting sales for future payment has been described as the very model of complexity, primarily due to a lack of a coordinated taxing structure. The general rule of installment reporting under section 453 provides that a taxpayer, under qualifying circumstances, may elect to report gain realized on a profitable sale ratably as payments are received. While this rule may be stated simply and clearly, it is a great deal more complex in practice.

Generally, the seller who does not elect or fails to qualify for statutory installment treatment under section 453 is taxed in the year of sale on the difference between the fair market value of the consideration received in the year of sale and the tax basis in the property sold. Later payments are tax free up to the amount of value received in the year of sale. Later receipts, so called "collection gain," is taxed as ordinary income if the obligor is not a corporation and as capital gain if the obligor is a corporation or a government entity.

However, under certain circumstances, a seller may defer recognition of gain on non-statutory grounds. This possibility causes much of the complexity in the area. Specifically, if the purchaser's promise of future payment is considered not to be the equivalent of cash, or if the expectation of future payment is sufficiently contingent or uncertain (for example, a specified percentage of all future profits), and thus is found to have no currently ascertainable fair market value, the seller arguably has received consideration of no value in the year of sale. In these circumstances the recognition of gain is deferred until the proceeds are received. Further, because the total amount to be received is uncertain, the seller reports gain on the "cost recovery" method, applying proceeds first against basis. Only when the total proceeds received exceed basis is gain recognized, and the gain generally is taxed as capital gain.

The installment method requires ratable recognition; each payment received is in part a return of the seller's basis and in part gain. Non-statutory deferred payment reporting is wholly different. Basis is recovered first. Thus, at times non-statutory deferred payment reporting can produce a greater measure of tax deferral than the installment method. Well-advised taxpayers often design transactions to achieve this advantageous result.

In general, a taxpayer becomes obliged to report gain and pay tax for the taxable year within which a sale takes place. Installment reporting and non-statutory deferred payment reporting are highly advantageous because they permit taxpayers to defer recognition of gain, and therefore payment of tax. Both thus operate as an interest-free loan from the Treasury. Taxpayers who sell property for notes are permitted to postpone paying tax on a profitable sale until the notes are paid; taxapyers who, for example, receive marketable securities or other property in an exchange must pay tax currently.

The ability to postpone payment of tax is a great advantage; a tax deferred is, in effect, a tax reduced. Congress initially enacted section 453 to provide relief to taxpayers who might have difficulty paying tax in the year of sale because receipt of payment was deferred. The reason for the creation of statutory deferred payment reporting should be kept in mind as this area is revised, especially in light of the even more advantageous cost-recovery benefits of non-statutory deferred payment reporting.

II. H.R. 3899

H.R. 3899 addresses five issues under section 453:

(1) Current law limits the amount of cash and other property (other than installment obligations) which may be received in the year of sale to 30 percent of the sale price. This limitation contributes to the complexity in the area; much of the litigation involves whether the 30 percent limitation has been met. The bill would eliminate the 30 percent limitation.

(2) The installment method is currently abused by taxpayers who sell appreciated property to related persons (for example, a trust set up for the benefit of the seller's children), who immediately resell the property to a third party as a part of a prearranged transaction. The original seller defers recognition of gain. The related person receives the full sale proceeds tax free because the tax basis of the property in the hands of the related person is its purchase price. Thus the economic unit comprised of the two related persons has cash equal to the value of the property while deferring taxation of the gain which would have been immediately payable had the initial sale been for cash. The bill would prohibit installment reporting of sales between related persons.

(3) The bill raises the current $1,000 floor on eligible sales of personal property to $3,000.

(4) The bill eliminates the requirement that there be two or more payments in separate taxable years for a sale to quality for the installment method.

(5) The bill makes it clear that the unreported gain from an installment sale is recognized by the seller's estate if the installment obligation is transferred or transmitted at death to the obligor.

III. Treasury Position on H.R. 3899

The Treasury Department believes that H.R. 3899 reduces complexity in the installment sale area. However, Treasury recommends that Congress take this opportunity to provide consistency of treatment and clarity of rules for all sales for future payment. While this effort might result in a more complex statutory provision -- indeed, it will require an expansion of section 453 to cover all deferred payment sales -- the law will be simplified immeasurably. A set of cogent, uniform rules based on sound policy will clear up the morass created by the lack of a coordinated taxing structure.

With the following qualifications Treasury supports H.R. 3899. First, Treasury supports the elimination of the 30 percent limitation only if a general rule requiring taxpayers to recover basis ratably over the term of any deferred payment sale is adopted and the abuse involving deferred payment sales to related persons is eliminated. Second, if tne 30 percent limitation is eliminated, we belive it is also appropriate to eliminate entirely the $1,000 floor for casual sales of personal property.

The 30 percent limitation has been criticized as adding a great deal of complexity to the tax law. It is the subject of a great deal of litigation and administrative dispute. Yet, the 30 percent limitation serves an important purpose. It limits access to the advantageous tax deferral afforded by section 453 to those taxpayer for whom the method was introduced into the law -- those with liquidity problems who could suffer a hardship if the tax on a defered payment sale was payable in full in the year of sale.

If only specific complexities are to be addressed by this bill, the 30 percent limitation should be rewritten in a manner which serves its original purpose with less complexity. However, we strongly believe that the simplification process should not be viewed so narrowly. Rather, where complexity is identified, it should be eliminated by uniform rules which accord with sound tax equity principles and, when compared to the prior state of the law, balance fairly the legitimate interests of taxpayers and the Treasury. Thus Treasury will support the elimination of the 30 percent limitation -- which we consider a major substantive liberalization and not merely a simplifying amendment -- as well as other liberalizing changes contained in our proposal, if other simplifying changes, which in some instances restrict presently available tax deferral

opportunities, are adopted in the same spirit. In this way we hope to establish an even-handed approach which may be applied as a precedent to future simplification efforts.

IV. Treasury Proposal

A. GENERAL RULE

The Treasury Department proposes a general and uncomplicated rule applicable to every sale for future payment. When recognition of gain is deferred, the seller's basis must be allocated ratably over the deferred payments. The specifics are set forth below.

I note that the Tax Simplification Committee of the Section of Taxation of the American Bar Association, the Tax Committee of the American Institute of Certified Public Accountants and the Tax Committees of the New York State and City Bar Associations testified in support of both the concept and the general framework of the Treasury proposals at the time the companion measure to H.R. 3899 (S. 1063) was the subject of hearings held by the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance. The American Bankers Association supported the Treasury proposal regarding sales to related parties. We have modified the proposal presented at that time to reflect the suggestions of these groups. While some differences on details remain, we hope to resolve them in the near future. It is, however, significant that in this initial simplification effort the Treasury and the major professional groups are in substantial agreement as to the appropriate Congressional action.

1. Recognition of Gain

a. Installment treatment

Unless a taxpayer otherwise elects, the gain on any sale of real property or casual sale of personal property (in any amount) will be recognized ratably as payments are received.

b. Non-installment treatment

i. Method of recognition. If a taxpayer so elects, gain shall be recognized in the year of sale, measured by the excess of the fair market value of the consideration received in the year of the sale over an allocable portion of basis. If the fair market value of consideration received in the year of sale is less than the

total amount due under the contract (e.g., there are contingent payments or the value of the notes does not equal the face amount of the obligations) then basis shall be allocated according to the rules set forth in 2 below. The amount of gain recognized on the receipt of notes will be added to basis and allocated ratably to future payments.

Under current law, the taxation of future collections in excess of basis is unrelated to and independent of the original sale, except for sales of inventory. The nature of the gain reported depends upon whether the note is a capital asset in the hands of the seller and upon the holding period. However, since collection is not a "sale or exchange" if the maker is an individual, capital gain treatment is unavailable. If the maker is a corporation and the note is a capital asset in the seller's hands, section 1232 treats the retirement as an exchange and capital gain treatment is permitted.

Under the proposal, gain attributable to future payments which exceed basis (adjusted for any gain reported on receipt of the notes) retains the same character (e.g., capital gain or ordinary income) as the gain originally reported, after application of the recapture rules and any adjustments for interest under section 483.

ii. Method of election. If the installment method is not to apply, a taxpayer must affirmatively elect not to report gain on the installment method, or actually report the gain in a manner inconsistent with the installment method.

2. Allocation of Basis

In any deferred payment sale, basis is to be allocated according to these rules whether or not gain is reported on the installment method.

a. Fixed contract price

As under current law, basis is allocated to each payment in the same proportion that the total basis bears to the total contract price. If the contract price is subject to change, the stated maximum payment will serve as the basis for the computation. The proportion would then be adjusted prospectively for any change.

Example 1. A, a cash basis taxpayer, sells real property with a basis of $5,000 to B for $10,000, $1,000 in cash and $9,000 in notes with interest. The notes, due in equal $3,000 installments on January 2 of the following three years, have a fair market value at the time of sale of $6,000. Whether or not the sale is reported on the installment method, A must allocate the $5,000 of basis over the fixed contract price of $10,000. Thus, 50 cents of basis would be allocated to each $1 of sales proceeds.

If A reports on the installment method, gain is recognized only as cash is received and A would report the following:

Year	Cash Received	Basis	Gain
1	$1,000	$ 500	$ 500
2	3,000	1,500	1,500
3	3,000	1,500	1,500
4	3,000	1,500	1,500

If A affirmatively elects not to report on the installment method, gain is recognized based upon the fair market value of the cash and notes received. Basis is still allocated over the fixed contract price. A would report the following:

Year	Taxable Proceeds	Basis	Gain
1	$7,000	$3,500	$3,500
2	3,000	2,500	500
3	3,000	2,500	500
4	3,000	2,500	500

In year 1, A must include in income the $6,000 fair market value of the notes, as well as the $1,000 cash down payment received. The fair market value of the notes is added to the basis of the notes as originally determined. Thus, in years 2-4, $2,000 of this $6,000 addition to basis is allocated to each $3,000 cash payment, leaving $1,000 taxable proceeds in each year from which the $500 basis originally allocated is deducted.

Example 2. B, a cash basis taxpayer, sells a machine with a basis of $5,000 for $1,000 down and the right to receive $1 per unit of output for the year of sale and the following three years, up to a maximum total purchase price of $10,000. The $5,000 basis is allocated over the maximum which may be paid, $10,000. Thus, 50 cents of basis would be allocated to each $1 paid to B, whether or not B reports on the installment method. The machine produced 0 units in the year of sale, 2,000 units in year 2, 2,000 units in year 3 and 4,000 units in year 4. B would report the following on the installment method:

Year	Cash Received	Basis	Gain
1	$1,000	$ 500	$ 500
2	2,000	1,000	1,000
3	2,000	1,000	1,000
4	4,000	2,500	1,500

The total paid to B was $9,000, $1,000 less than the maximum. B recovers the remaining basis in year 4, the final year of the contract. If year 4 production had been 2,000 units, B would have reported a loss of $500 in that year.

If B had elected not to report on the installment method, and his right to receive $1 per unit was considered to be so uncertain as to have no ascertainable fair market value, B would have reported the following:

Year	Cash Received	Basis	Gain
1	$1,000	$ 500	$ 500
2	2,000	1,000	1,000
3	2,000	1,000	1,000
4	4,000	2,500	1,500

The cost recovery method of reporting is not permitted, even if B's right to receive $1 per unit has no ascertainable fair market value. Thus, there is no incentive to arrange transactions artificially with notes or similar promises arguably having no ascertainable fair market value. As a result, valuation problems are avoided and commercial transactions will not be structured artificially to achieve desired tax results.

b. Specified number of years

Where payments under a contract are to be made over a specified number of years, in general, basis is allocated equally to each year. Where basis allocated to any year exceeds the amount received in that year, no loss is allowed. The excess is added to total unrecovered basis and reallocated equally to the remaining years of payment. Any basis remaining at the end of the specified period may then be treated as a loss.

Example 3. C, a cash basis taxpayer, sells a machine with a basis of $5,000 for the right to receive $1 per unit of output for the year of sale and the following three years (with no maximum on the amount C might receive). The machine produces 2,000 units in year 1, 3,000 units in year 2, 4,000 units in year 3 and 5,000 units in year 4. C would report the following on the installment method:

Year	Cash Received	Basis	Gain
1	$2,000	$1,250	$ 750
2	3,000	1,250	1,750
3	4,000	1,250	2,750
4	5,000	1,250	3,750

Again, an argument by C that the right to receive $1 per unit had no ascertainable fair market value would not affect the amounts reported.

Example 4. D sells a machine under the same terms as in Example 3. The machine produces 950 units in year 1, 2,000 units in year 2, 3,000 units in year 3, and 4,000 units in year 4. D would report the following on the installment method:

Year	Cash Received	Basis	Gain
1	$ 950	$ 950	$ 0
2	2,000	1,350	650
3	3,000	1,350	1,650
4	4,000	1,350	2,650

Although $1,250 of basis is initially allocated to year 1, D received only $950. D may not report a loss for year 1, and must allocate the excess of $300 equally over the following 3 years.

There may be instances in which taxpayers can demonstrate with reasonable certainty from the outset of a transaction the amount and timing of the income to be received under a contingent payment contract. In such cases it may be inappropriate to require basis to be allocated equally to each year of the payment contract. Accordingly the Secretary would be granted regulatory authority to prescribe those situations in which the general rule will not apply and the method of basis recovery to be used.

3. Special Rule

Under the foregoing rules, a contingent payment component may be manipulated to achieve some measure of cost recovery initially. For example, assume E sells a machine with a basis of $20,000 for the right to receive $20,000 in each of years 3 and 4 and $1 per unit of output in years 1-4. The machine produced 5,000 units each year. Under the rules set forth above, E would report the following on the installment method:

Year	Cash Received	Basis	Gain
1	$ 5,000	$5,000	$ 0
2	5,000	5,000	0
3	25,000	5,000	20,000
4	25,000	5,000	20,000

By structuring the receipt of contingent payments first in an amount estimated in advance to be approximately equal to the basis allocated to each year, E has achieved cost recovery and tax deferral. E could achieve a similar result by receiving fixed payments of $5,000 each in years 1 and 2, fixed payments of $15,000 each in years 3 and 4 and contingent payments of $2 per unit of output in years 3 and 4.

Treasury proposes a special rule providing that the existence of a contingent payment component shall in no event accelerate basis recovery. The operation of this rule is illustrated by the following example.

Example 5. E sells a machine with a basis of $20,000 for the right to receive $20,000 in each of years 3 and 4 and $1 per unit of output in years 1-4. The machine produced 5,000 units in each year. E would report the following on the installment method:

Year	Cash Received	Basis	Gain
1	$ 5,000	$ 0	$ 5,000
2	5,000	0	5,000
3	25,000	10,000	15,000
4	25,000	10,000	15,000

c. Both fixed price and specified term

When the terms of sale include both a fixed contract price (or standard maximum) and payments over a specified number of years, the taxpayer must allocate basis over the fixed price (or maximum).

d. Neither fixed price nor specific term

Where the contract specifies no fixed price (or maximum) and payments are not limited to a specified number of years, basis may, in general, be recovered ratably over a period of 20 years if the transaction is a sale or exchange. As in the case of payments limited by time only, the Secretary will be authorized to define situations by regulation in which this general rule will not apply and to prescribe alternative methods of basis recovery.

B. EVENTS CAUSING ACCELERATION OF DEFERRED PAYMENT INCOME

1. Section 337 Liquidations

Under present law, a corporation generally recognizes no gain upon the distribution of installment obligations to its shareholders pursuant to a twelve-month liquidation under section 337, except for recapture and other similar items. However, shareholders are taxed upon receipt as having received a distribution equal to the fair market value of the notes. Shareholders generally recover basis first rather than allocate basis between notes and other property received.

Under the proposal, if a corporation sells property pursuant to a section 337 liquidation, receives notes as part of the consideration and distributes those notes in a liquidating distribution, shareholders would report gain as if the stock had been sold on the installment method for the cash or other property received in the liquidating distribution, unless they elect otherwise. Basis would be allocated according to the general rules specified above, either ratably over the value of the property distributed and the face amount of the notes or equally to each year during which a payment may be made from the liquidating corporation or on the notes. Shareholders would be taxed with respect to the notes only upon receipt of payment. If taxpayers elected not to report on the installment method, notes or other obligations would be reported as income under the general rules set forth in A.b.i. and A.2. above. These rules would apply only to notes attributable to sales made by the corporation pursuant to the section 337 liquidation.

A special rule would cover liquidating distributions spanning two taxable years of a shareholder. Under current law, basis is recovered first. This rule would not be changed. In the first year, the shareholder would report gain without regard to what might be received in the second year. This is appropriate since in many cases it will be impossible to predict the form or value of future distributions.

Distributions received in the second year would be subject to a new rule. The shareholder would be treated as if all liquidating distributions had been made in the second year, except that gain reported in the first year would be subtracted from the gain that would have been recognized had the entire distribution occurred in the second year.

Example 6. F is the sole shareholder of corporation X and has a basis of $100,000 in the stock. F causes X to adopt a plan of liquidation pursuant to section 337 in July of year 1. In September of year 1, X sells all of its assets to D for $1,000,000, $500,000 in interest-bearing notes with a fair market value of $350,000, due in equal installments in years 3-6. The cash is distributed in November of year 1 and the notes in February of year 2. F would recognize $400,000 of income in year 1 ($500,000 of cash minus $100,000 of basis).

In year 2, F is treated under the installment method as having received all of the distributions in year 2, factoring out gain reported in year 1. If X had distributed everything in year 2, F would have reported $450,000 in gain ($500,000 cash minus $50,000 basis allocated to cash), and F would have held $500,000 face amount notes with a basis of $50,000. When the $400,000 gain recognized by F in year 1 is subtracted ($450,000 in year 2 minus $400,000) $50,000 of gain remains for F to report in year 2. F's basis for the notes is $50,000, which will be recovered ratably as the notes are paid.

If F elects not to repoprt on the installment method, F reports the same $400,000 in year 1. Again in year 2, F is treated as having received all of the distributions in year 2, subtracting the gain recognized in year 1. In this case, if X had distributed everything in year 2, F would have reported $765,000 in gain ($500,000 - $50,000 in basis attributable to the cash plus $350,000 minus $35,000 in basis attributable to the notes). When the $400,000 gain recognized in year 1 is subtracted, F recognizes $365,000 of gain in year 2. F holds the notes at a basis of $365,000 ($50,000 basis allocated to the notes plus $315,000 gain recognized upon receipt of the notes).

2. Sales to Related Parties

Sales to family members, controlled corporations and partnerships, or to trusts and estates in which a related person has a specified interest would be subject to a special disposition rule. A subsequent disposition by the purchaser within two years of the original sale will result in the acceleration of gain recognition on the installment obligations held by the seller equal in amount to the consideration received in the second sale (or amount of charitable contribution deduction taken if the subsequent disposition is a contribution to a charitable organization). Certain dispositions would be excepted -- dispositions upon the death of the purchaser, involuntary conversions, sales in the ordinary course of a business which was the subject of the installment sale, and redemptions described in sections 302(a) or 303(a). A subsequent sale for deferred payment will be treated as a dispostion of the obligation from the original sale only when payment is received.

Under regulations to be promulgated by the Secretary, the seller would be required to file a consent with the year-of-sale tax return which identifies the purchaser, the

relationship between purchaser and seller and the nature of the transaction, and pursuant to which both the seller and purchaser agree promptly to notify the Internal Revenue Service of any subsequent disposition by the purchaser within 2 years.

The proposal is narrowly structured to deny deferred payment treatment only where the related party unit is attempting to achieve the dual goals of tax deferral and immediate use of the economic benefits of the transferred property. It therefore will not affect installment sales of farms or interests in closely held businesses where the purchaser intends to continue the business activity. However, because of the precise focus of the proposal, we believe it is appropriate to define related persons broadly. Thus, persons will be treated as related if stock ownership in any amount would be attributed from one to the other under the rules of section 318(a), except that "members of a family" would be expanded to include brothers and sisters (whether of the whole or half blood), spouses of members of the family and members of the family of one's spouse.

Example 7. G sells property with a $10,000 basis in year 1 to spouse S for $45,000 in notes, due $15,000 each in years 3-5. Still in year 1, S sells the property for $45,000 cash. G is treated as having disposed of S's obligations in year 1.

Example 8. Same facts as Example 7, except that S sells the property in year 1 for $45,000 in notes, payable $25,000 in year 3 and $20,000 in year 4. G is treated as having disposed of obligations in the face amounts of $25,000 in year 3 and $20,000 in year 4. Although S received payment after the two-year period elapsed, the fact that the sale occurred within that time causes this provision to apply.

3. Sales by Estates

An executor of an estate (or trustee of testamentary trust or trust used as a will substitute) would be permitted to sell property within 2 years of the date of the decedent's death on the installment method and distribute the obligations received without the distributions being treated as a disposition which accelerates gain recognition. The distributee would take the estate or trust's basis for the obligations.

C. CLARIFICATION OF CURRENT LAW

1. Cancellation of Obligations.

Under some current case law, it may be argued that a cancellation of an installment note is not a disposition. The proposal would amend sections 453(d) and 691(a)(2) to make it clear that a taxable disposition occurs when the holder cancels or forgives an obligation or bequeaths an item of income in respect of a decedent to the obligor. In the latter case, income is recognized in the taxable year of the entity holding the obligation during which the obligation is cancelled or distributed.

2. Obligations held in trust which are transmitted at death.

Some court decisions have held that the section 691(c) deduction is not available for deferred receipts on installment obligations held by a trust that is included in a decedent's estate. The section 691(c) deduction would be available for installment obligations in existence at the date of the decedent's death held by a trust that is included in the decedent's gross estate.

3. Sale for less than fair market value.

A taxpayer who disposes of installment obligations in a sale for less than fair market value (e.g., to a related person) would be taxed on the excess of the fair market value of the obligation over its basis, and not on the lower sales price.

D. Miscellaneous Provisions

1. Like-Kind Exchanges with Installment "Boot"

Under current law, a taxpayer under qualifying circumstances may defer recognition of gain realized in a sale by electing the installment method of reporting or in an exchange if the property received in whole or in part was of a "like-kind" to the property given up. However, deferral is unavailable to the same extent when a transaction qualifies as both a like-kind exchange and an installment sale, because the property received in the exchange is treated as a year-of-sale payment under the installment sale rules, although gain attributable to the like-kind exchange is not recognized. Treasury proposes that, subject to the

resolution of technical problems, the value of like-kind property received in a deferred payment sale not be taken into account in determining selling price, contract price or payments received.

2. Selling Expenses

Selling expenses would be deducted from the gross sales price.

3. Two Payment Rule

The rule requiring payments in two or more taxable years would be eliminated explicitly.

4. Marketable Securities

Marketable securities could not be sold on the installment method. The definition of "marketable securities" would exclude large blocks not immediately saleable in an open market transaction.

As discussed above, deferred payment reporting is designed to provide relief to taxpayers who might have difficulty paying tax when receipt of proceeds is deferred to future years. In the case of marketable securities, the decision to sell for future payment, and thereby create a situation which in form qualifies for deferred payment treatment, lies totally in the hands of the seller. A ready cash market is available. The only purpose for sale on those terms is to qualify for tax deferral. This is inconsistent with the relief nature of section 453.

5. Section 1038

A decedent's estate will be permitted to qualify for section 1038 treatment where a qualifying sale had been made by the decedent.

IV. Summary

Simplification in this area is important for several reasons:

- Clearer application of the tax law will facilitate business and financial planning.

- If the rules are simpler and more certain, taxpayers and the Government can devote less time and expense to consturing and arguing about the proper application of the Code to specific situations.

- With streamlined rules, there will be fewer instances where tax savings are dependent upon a practitioner's knowledge of arcane wrinkles in the law, and where penalties are imposed on taxpayers with less knowledgeable tax counsel.

- Simplification will also reduce the benefits enjoyed by some aggressive taxpayers and practitioners who play the "tax lottery" -- the game of calling uncertain rules in your favor in the hope, if the expectation, that the transaction will not be audited.

Specifically, we believe the installment sale area is an appropriate place to begin the process of substantive simplification and entertain the hope that all interested parties will cooperate in an effort to consummate this project successfully. We further believe that if the proposals set forth in this statement are adopted, two major causes of complexity in the deferred payment area, e.g., whether a transaction is "open" or "closed" and whether a promise of future payment has an ascertainable fair market value, will be eliminated, commercial transactions will not be structed artificially to achieve full basis recovery prior to the recognition of any gain and the deferred payment reporting privilege will be made available in a uniform and fair manner.

H. R. 3900--THE SUBTITLE F REVISION ACT OF 1979

In addition to providing a forum to achieve simplification of substantive areas of the tax law, this Subcommittee can make a significant contribution to fostering efficient administration of the tax laws. The Subtitle F Revision Bill is a example of this process and Treasury looks forward to participating with interested professional groups in continuing efforts to simplify tax administration. With three minor amendments, Treasury supports H. R. 3900.

I. Section 2

Section 2 of the bill would amend section 6343(b) to provide that where there is a subsequent administrative determination by the the Internal Revenue Service that a

seizure for the collection of a delinquent taxpayer's liability was wrongful, interest, at the statutory rate, would be paid to the taxpayer. Under present law, interest is payable only when there is a judicial determination of wrongful levy. Interest ought also to be payable when there is an administrative determination by the Internal Revenue Service that a wrongful levy has been made. Therefore, Treasury supports this change.

We do, however, recommend a technical amendment. The bill provides that interest is to be paid until the date the money is returned. Literally, this is impossible to do. Under section 6611(b)(2) interest is computed until a date preceding the check by not more than 30 days. We suggest that this section of the bill be amended to provide that interest be paid for the period described in section 6611(b)(2).

II. Sections 3 and 4

Sections 3 and 4 of the bill incorporate changes proposed by the Internal Revenue Service. Presently, private foundations are required to file two annual returns, one under section 6033 and another under section 6056. The proposal would consolidate the two reporting requirements into one, under section 6033. In addition, non-exempt charitable trusts described in section 4947(a)(1), whose returns are presently filed pursuant to section 6011, will also be required to file the annual return (including the additional reporting requirements heretofore required under section 6056) required under section 6033.

The proposed change would subject all private foundations to section 6033 and would permit a wholesale consolidation of sections 6033 and 6056. In addition to streamlining the Federal filing requirements for private foundations, the proposal would facilitate efforts underway to bring state filing requirements into line with the Federal requirements. If the efforts to coordinate state and Federal filing requirements prove successful, the net effect would be a very substantial reduction in the paperwork burden on the Internal Revenue Service, state governments and affected foundations. This would be welcome simplification and the Treasury supports these sections of the bill.

There is an additional area of further simplification not presently addressed in the bill. When hearings on the Senate counterpart of H.R. 3900 (S. 1062) were held before

the Senate Finance Subcommittee on Taxation and Debt Management, the American Bankers Association and the Committee of Banking Institutions on Taxation recommended the simplification and consolidation of the reporting requirements of split interest charitable remainder or lead trusts. Presently, splitinterest trusts are required to file as many as three seprate returns with different filing dates under two different Code sections. The returns are substantially duplicative. The American Bankers Association and the Committee of Banking Institutions on Taxation have recommended consolidation of these reporting requirements into a single form containing the information presently required on the various separate forms. Treasury has been working with these organizations to achieve reporting simplification while retaining the appropriate public disclosure of return information. Accordingly, we recommend that the bill be expanded to include consolidation of the filing requirements of split interest trusts.

III. Section 5

Section 5 of the bill would repeal section 6658, which provides for an additional 25 percent penalty in the case of termination assessments. This change was originally proposed in 1976 in connection with revisions to the termination and jeopardy assessment procedure in the Tax Reform Act of 1976.

It has been the experience of the Internal Revenue Service that this provision, which provides an additional panalty, is not needed. Consequently, the Treasury supports its repeal.

IV. Section 6

Section 6 would eliminate the requirement that corporations file a return with the Internal Revenue Service concerning certain stock options. The section also eliminates the requirement, that a corporation furnish certain information to a person who exercises a restricted stock option.

Treasury understands there are still some restricted stock options outstanding. The information supplied by corporations is necessary to enable holders of stock acquired through the exercise of restricted stock options to determine their basis. Thus, while Treasury supports this section of the bill we suggest it be amended to continue to require corporations to furnish information to individuals who exercise restricted stock options.

V. Section 7

Tax professionals feel that many individuals do not become aware of their gift tax return responsibilities until a review of transactions for the previous calendar year is made in connection with their individual income tax return, due April 15. At this time the gift tax return is already late.

Section 7 would coordinate the time for filing gift tax returns for the fourth calendar quarter with the April 15 income tax return filing date in order to consolidate an individual's tax responsibilities on one date. An extension of time to file an income tax return will also extend the time to file the fourth quarter gift tax return. The Treasury does not oppose this provision.

VI. Section 8

Section 8 would permit excise tax information to be disclosed to state tax officials. The Treasury supports this provision.

MISCELLANEOUS BILLS

I shall now turn to the five miscellaneous bills before the Subcommittee today. The Treasury position on each of these bills is set forth in Appendix A. I shall comment upon only two of the bills, H.R. 2770, The Independent Local Newspaper Act of 1979, and H.R. 2536, relating to penalties for failure to pay estimated tax.

I. H.R. 2770 -- The Independent Local Newspaper Act of 1979

Earlier in this statement I discussed the importance of tax simplification and noted that tax complexity results in many instances from attempts to provide narrowly drawn special interest legislation and/or the use of the tax Code to achieve some social, economic or regulatory objective. It is fitting that H.R. 2770 should be considered in this context because that bill illustrates quite clearly the points I made earlier.

The objective of H.R. 2770 is to preserve local ownership of newspapers in the face of increasingly aggressive acquisition offers, at premium prices, by large newspaper chains or conglomerates. If the owner of a local

newspaper declines to sell and dies owning the newspaper, the estate tax value of the business is determined in part by reference to recent sales of comparable newspapers, which, it is alleged, are occuring at unrealistic, inflated prices. It is further alleged that a newspaper valued in this manner cannot generate funds sufficient to pay estate taxes. As a result local newspaper owners, at death or prior thereto in contemplation of this dilemma, are encouraged to sell out to the large chains.

The bill attempts to solve this dilemma by providing an extraordinary number of special exemptions from generally applicable tax provisions to permit the tax-free accumulation of funds to pay the estate tax attributable to the value of the newspaper and permitting any unfunded estate tax to be paid over fifteen years. Thirty seven pages of statutory language are required to codify these provisions.

We have no quarrel with the proposition that a free and vigorous press should be protected. But if this is to be a of national policy goal, we believe the problem should be addressed directly. If the independent local newspaper industry is threatened, special loan or subsidy programs should be considered. To the extent the value of these businesses is being artificially escalated by takeover bids from large newspapers, the possible modification of the anti-trust laws should be considered. Either or both of these courses would result in a more controlled and equitable resolution of the problem than the use of tax expenditures.

I believe this point can be made clear by examining H.R. 2770 in some detail. The bill is divided into two principal parts. The first permits the establishment of a trust by an independent "local" newspaper for the purpose of paying the estate tax attributable to any owner's interest in the business. The trust must have an independent trustee and its corpus may be invested only in United States obligations. The value of the trust cannot exceed 70 percent of the value of the owner's interest in the business. The income earned on the trusteed assets will be exempt from tax. The transfer of assets to the trust is deductible by the newspaper business, but is also excluded from the taxable income of the owner. The corpus of the trust is excluded from the owner's gross estate and the estate does not realize income when its estate tax liability is discharged by the trust.

The newspaper must have all its publishing offices located in a single state, and if it is a partnership or corporation, it cannot be traded on an established securities market. Deductions for transfers from the business to the trust are limited to 50 percent of the business profits. The estate tax benefit is "recaptured" if the business interest is sold within 15 years of the owner's death.

The second part of the bill provides for an elective deferral of the estate tax attributable to the newspaper interest not otherwise paid from the assets of the special estate tax payment trust. Payment may be made on essentially the same terms as Code section 6166, with the same preferential 4 percent interest rate, but without regard to the size of the interest in relation to the owner's estate.

What generally applicable tax law principles does this bill violate? First, it permits a deduction for earnings diverted to the estate tax payment trust. Although the bill provides that such a deduction is allowable under section 162, the payment in no way can be said to meet the "ordinary and necessary" business expense criteria of that section. Nor, is there in the tax law any other provision similarly allowing a deduction for amounts to be used to pay death taxes.

Second, the bill provides that the funds transferred to the estate tax payment trust will not be included in taxable income by the owner. To the extent that the newspaper business is held in corporate form, this payment would in all other cases be treated as a taxable dividend.

Third, the exemption of trust earnings from income is contrary to existing law which would treat the beneficiary as the owner of the trust and taxable on its income.

Fourth, exclusion of the corpus of the trust from the owner's gross estate violates existing principles which would include in a decedent's estate any asset in which the decedent or his estate had an interest.

Finally, if it was appropriate to exclude the funding and earnings of the trust from the decedent's estate, then the exclusion from estate income of the amount paid by the trust to relieve the estate of its estate tax liability contravenes the basic income tax rule that discharge of an obligation of another results in income to the party whose obligation has been discharged.

The effect of these provisions is, in most cases, to cause the federal government to pay at least 46 percent of the estate tax liability attributable to the value of an independent local newspaper. This occurs because, assuming a 46 percent corporate tax rate, the income tax on the "deductible" contribution to the estate tax payment trust is not collected. Moreover, the government's share of the estate tax payment would be increased if these funds were distributed as taxable dividends to the shareholder or if these funds were invested and produced taxable income at either the corporate or shareholder level. Finally, the government also forgives a portion of the estate tax by the failure to include the value of the trust in the owner's estate.

Apart from its significant departure from accepted tax principles the bill has other deficiencies. The benefits are available to any shareholder of an independent "local" newspaper, no matter how many shares are owned and without regard to whether such ownership creates an estate tax liquidity problem. Although there is substantial income tax relief granted by the bill, there is no recapture of these benefit if the family of the owner does not continue to operate the local newspaper. Furthermore, a qualified trust may be established only if no stock of the newspaper is publically traded. However, the trust becomes disqualified only if the stock owned by the trust beneficiary becomes traded in an established securities market. Finally, the limits on the trust are established on the assumption that the highest possible estate tax rate (70 percent) will apply in all cases.

While we are sympathetic to the plight of some owners of small businesses in planning the payment of estate taxes while retaining control of their business in the heirs, we oppose this special relief for one group of "small businessmen." We well understand that these problems have in some cases increased following the enactment of the Tax Reform Act of 1976.

It must be noted, however, that present law already provides relief for small business owners and their heirs. Section 303 provides that in certain cases the redemption of stock by a corporation to pay estate taxes will be treated as a redemption and thus subject to capital gains rather than ordinary income tax. Also, if a portion of the business must be sold to generate funds to pay estate taxes, any gain realized will generally be taxed at the capital gains rate.

Further, the transaction can often be structured as an installment sale, in which case the payment of the income tax is deferred over the installment payment period.

In computing the estate tax, there are special relief provisions. In the 1976 Act, the amount of property which may be passed without being subject to the estate tax was increased from $60,000 to $175,000. Also, the marital deduction for transfers to surviving spouses, which before the 1976 Act was limited to one-half the estate, was changed to a limit of the greater of 50 percent of the value of the adjusted gross estate or $250,000.

Finally, the payment of the estate tax may be deferred where a business interest constitutes a major part of the estate. Under section 6161(a) the time for payment of the estate tax may be extended for up to 10 years upon a showing of reasonable cause. Reasonable cause exists when an estate consists largely of a closely-held business and does not have sufficient funds to pay the tax on time, or must sell assets to pay the tax at a sacrifice price. Section 6166 allows a five-year deferral and 10-year installment payment at a 4 percent interest rate on all or a portion of the deferred estate tax if the value of the closely-held business interest exceeds 65 percent of the adjusted gross estate. Finally, section 6166A is applicable to a broader number of situations, those in which the value of the closely-held business interest is either 35 percent of the gross estate or 50 percent of the taxable estate. Under that section the estate tax attributable to the closely-held business interest may be paid in up to 10 annual installments.

The adoption of H.R. 2770 would provide a wedge to be used again and again by other segments of society, each arguing its own importance. We do not believe in this piecemeal approach to legislation. There are existing provisions intended to minimize the problems inherent in the payment of taxes. If they are inadequate they should be reviewed in a comprehensive and not an *ad hoc* manner.

II. H.R. 2536 -- DE MINIMUS RULE FOR ESTIMATED TAXES

H.R. 2536 relaxes the requirement for filing declarations of estimated tax. Under current law, no declaration of estimated tax is required if a taxpayer reasonably expects that the amount of taxes which would be

owed with the taxpayer's return, over and above amounts withheld from wages and other tax credits, would be less than $100. The bill would raise this de miniums exception to $500. In addition, no penalty would be imposed on individuals for failure to pay estimated income tax if the tax reported on the individual's return is less than $500.

The rules for estimated tax payments place taxpayers who receive income on which there is no withholding on a pay-as-you-go system similar to the system applied to wage earners. The pay-as-you-go system is beneficial for the Government, which receives taxes throughout the year, and for the taxpayer, who is not faced with paying a large amount of tax when filing a tax return on April 15.

Because current law provides a number of exceptions to the estimated tax requirement, a taxpayer with a high income tax liability might underpay taxes by a few thousand dollars and still not be subject to a penalty for failure to pay estimated tax. In contrast, though, a relatively low-income taxpayer with steady income might fail the safe harbor tests in the Code even if the taxpayer's underpayment of tax is a relatively small amount. We believe it is appropriate to increase the overriding safe harbor rule for filing declarations of estimated taxes from its present $100 level so that a taxpayer who does not expect to pay a substantial amount to the Government with his or her return will be permitted to avoid the paperwork involved in making estimated tax payments. However, we believe what it would be unwise to raise the safe harbor figure to $500 at this time. As indicated above, the estimated tax rules are not solely for the benefit of the Government. They also benefit individuals who would otherwise be faced with a large tax bill on Aril 15. The $100 figure was incorporated in the Code in 1972. Before then, the safe harbor rule was applied with a $40 figure. We believe it would now be appropriate to raise the limit to $300.

We also believe that in conjunction with increasing the safe harbor amount it would be appropriate to increase the minimum percentage of annual tax liability to be met by withheld and estimated tax payments from 80 percent to 85 percent. Taxpayers whose liabilities are paid as estimated taxes pay their taxes substantially later than those whose liabilities are satisfied through withholding. This change would reduce the advantage of paying taxes through estimated payments and would reduce the amount payable in a lump sum with the taxpayer's return.

I would be happy to answer any questions you may have.

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Appendix A

Summary of Treasury Positions on 5 Miscellaneous Bills Scheduled for Hearing on July 27, 1979 Before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means

H.R. 2536. The Treasury Department agrees that the amount of tax due before estimated tax is required should be raised. However, Treasury believes that the new figure should be $300 so that taxpayers on fixed incomes are not subjected to large tax liabilities on April 15. In addition, Treasury recommends that the minimum percentage of tax liability to be met by withheld and estimated taxes should be increased from 80 percent to 85 percent.

H.R. 2770. The Treasury Department opposes the bill.

H.R. 3660. The Treasury Department does not oppose the bill.

H.R. 4201. The Treasury Department does not oppose the bill.

H.R. 4726. The Treasury Department supports the bill on the understanding that the amount of the credit or refund for warranty adjustments will be computed in a manner consistent with Rev. Rul. 76-423, 1976-2 C.B. 345.

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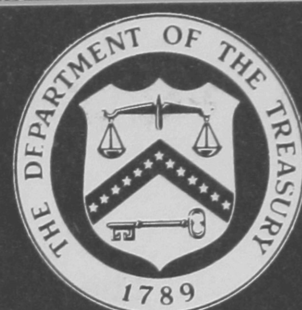

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
July 27, 1979

STATEMENT OF THE HONORABLE ROBERT H. MUNDHEIM
GENERAL COUNSEL OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL
ECONOMIC POLICY AND TRADE
AND THE
SUBCOMMITTEE ON ASIAN AND PACIFIC AFFFAIRS
OF THE
HOUSE COMMITTEE ON FOREIGN AFFAIRS

H.R. 2200 - International Claims Settlement Act Amendments

I am very pleased to present the views of the Treasury Department on H.R. 2200. This bill would amend the International Claims Settlement Act of 1949 to provide for adjudication by the Foreign Claims Settlement Commission of claims of U.S. nationals for losses of property taken by the Socialist Republic of Vietnam.

At the outset, I should say that the Treasury Department supports H.R. 2200. More than four years have already elapsed since the Socialist Republic of Vietnam took control over South Vietnam, resulting in substantial losses of American property. As more time passes, it becomes all the more difficult for claimants to present the Commission with the necessary evidence of their losses. Since claims should be adjudicated on the basis of the best possible evidence, we would favor enabling claimants to present their claims to the Foreign Claims Settlement Commission promptly.

Determination of the amount of claims would also be important in the event that the U.S. entered into future claims settlement negotiations with the Government of the Socialist Republic of Vietnam. In negotiating the recent private claims settlement with the People's Republic of China, it was helpful to have available the Commission's determination of claims against China under Title V.

B-1759

From Treasury's perspective, we do not believe that the establishment of a Vietnam claims program will have any implications for U.S. relations with Vietnam.

I would like to comment on several aspects of the bill as proposed.

First, we in Treasury support the provision in Title VII for payment of claims under a new distribution formula based on the $2500 minimum proposed by the GAO study in 1977, rather than on the $1000 minimum which would otherwise be employed under Title I.

Second, while it does provide for certification of awards to Treasury for payment purposes, the bill does not provide for certification of awards to the individual claimants, or to the Secretary of State. There may well be a lapse of time between the certification of claims by the Commission and actual payment by Treasury pursuant to a claims settlement, and since the Secretary of State may require the information for negotiating purposes. Therefore, it might be advisable to include language similar to that found in section 507 (a) and (b), authorizing the Commission to make such certifications.

Third, the claims fund established under the proposed Title VII appears to operate only the case of a future cash settlement with Vietnam. We would suggest a slight modification in the bill also to authorize the use of the claims fund where a settlement takes the form of an assignment of assets to the U.S. from which sums can be realized for distribution to U.S. claimants.

You have specifically asked for the current estimate of blocked Vietnamese assets. We estimate that roughly $140 million of assets are blocked, on the basis of information available to Treasury including the results of an informal telephone survey conducted by Treasury through the New York and San Francisco Federal Reserve Banks in late 1976.

I would also state that the Department of the Treasury supports the changes in the definition of Vietnam and in the indirect ownership test suggested by the Department of State in its testimony.

This concludes my oral testimony on the bill. I appreciate having this opportunity to share my views with you. I would be happy to try to answer any questions you might have.

Technical Comments

In addition to the above substantive comments, I would recommend the following technical changes in the language of the bill:

(1) Section 700: Change page 2, line 8 to read: "the Socialist Republic of Viet-Nam which arose since April 29, 1975 out of the na- "

(2) Section 701(1): Add to the end of the subsection, after line 2 on page 3, the following: "The term does not include aliens."

(3) Section 701(3): change page 3, lines 7-9 to read: "any debt owed by the Socialist Republic of Viet-Nam or by any enterprise which has been nationalized, expropriated, or taken by the Socialist Republic of Viet-Nam, and any debt which is a charge on property which has been nationalized, expropriated or taken by the Socialist Republic of Viet-Nam."

(4) Section 701(5): Change page 3, lines 14-20 to read:

(5) the term "Claims Fund" is the special fund established in the Treasury of the United States composed of such sums as may be paid to or realized by the United States pursuant to the terms of any agreement settling such claims that may be entered into by the Governments of the United States and the Socialist Republic of Vietnam.

(5) Section 702: Change page 4, line 1 to read:

"Viet-Nam, arising since April 29, 1975 for losses arising as a result of the nationalization."

(6) Section 703: Change page 4, line 21 to read:

"only to the extent that the claim has been held by one or more nationals..."

(7) Section 704: page 5, lines 5, 9, 15, and 22: Change "may" to "shall".

(8) Section 706: Add at page 16, line 17:

"(a) The Commission shall certify to each individual who has filed a claim under this subchapter the amount determined by the Commission to be the loss or damage suffered by the claimant which is covered by the subchapter. The Commission shall certify to the Secretary of State such amount and the basic information underlying that amount, together with a statement of the evidence relied upon and the reasoning employed in reaching its decision.

(b) The amount determined to be due on any claim of an assignee who acquires the same by purchase shall not exceed (or, in the case of any such acquisition subsequent to the date of determination, shall not be deemed to have exceeded) the amount of actual consideration paid by such assignee, or in case of successive assignments of a claim by any assignee.

(c) With respect to any claim under section 702"

(9) Section 710: Change page 8, line 22 to read:

"Notwithstanding any other provision of law, the Secretary of State and the Secretary of the Treasury shall transfer or other-."

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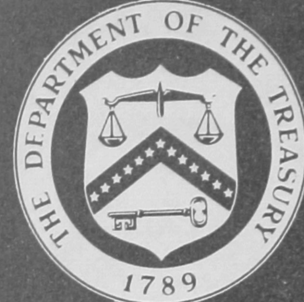

FOR IMMEDIATE RELEASE
Friday, July 27, 1979

CONTACT: Robert Nipp
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INTEREST RATE BASE FOR NEW SMALL SAVER CERTIFICATE

Secretary of the Treasury W. Michael Blumenthal today advised the supervisory agencies for Federally-insured depository institutions that the average 4-year Treasury yield curve rate during the five business days ending July 26 was 8.95 percent, rounded to the nearest 5 basis points.

(This rate will be used by the agencies in determining the maximum interest payable in August on time certificates issued in denominations of less than $100,000 and maturities of four years or more.

The report of the Treasury yield curve average is announced three business days prior to the first day of each month for determination of ceilings for the new variable rate savings certificates which are adjusted on the first calendar day of each month.

The commercial bank ceiling for the certificate is one and one-quarter percentage points below the yield on the four-year Treasury securities. The ceiling for thrift institutions is one percentage point below the yield on four-year Treasury securities.)

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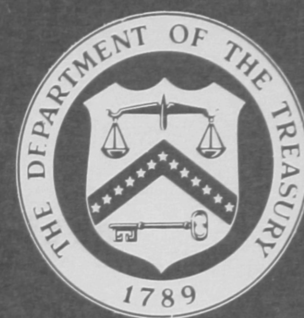

FOR IMMEDIATE RELEASE
EXPECTED AT 10:30 A.M., EDT
MONDAY, JULY 30,1979

STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON COMMERCE, CONSUMER
AND MONETARY AFFAIRS
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

U.S. POLICY TOWARD FOREIGN DIRECT INVESTMENT IN THE UNITED STATES: THE ROLE OF THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES.

I am happy to respond to your request to testify on the operations of the Committee on Foreign Investment in the United States (CFIUS). Since the basic terms of reference for the Committee stem from our overall policy on foreign investment, I first want to outline that policy and the reasons for it. I will then describe how the Committee operates in the context of that policy.

U.S. Policy

The United States has a long-standing policy of welcoming foreign investment to this country and extending national treatment to foreign owned firms based in the United States. Prior to 1977, however, this policy had never been officially

articulated. Upon assuming office, this Administration decided to do a formal review of U.S. policy on both inward and outward investment.

The review was carried out by the Economic Policy Group, the Administration's top policy-making body for all economic issues. It resulted in a statement, issued in July 1977, confirming the long-standing U.S. commitment to an open international economic system. The statement concluded that:

> The fundamental policy of the U.S. Government toward international investment is to neither promote nor discourage inward or outward flows or activities.
>
> The Government therefore should normally avoid measures which would give special incentives or disincentives to investment flows or activities and should not normally intervene in the activities of individual companies regarding international investment. Whenever such measures are under consideration, the burden of proof is on those advocating intervention to demonstrate that it would be beneficial to the national interest.

The statement also confirmed the U.S. commitment to national treatment by stating that governments "should

not discriminate against established firms on the basis of nationality or deprive such firms of their rights under international law."

The basic premises for the policy statement were stated as follows:

-- First, international investment will generally result in the most efficient allocation of economic resources if it is allowed to flow according to market forces.

-- Second, there is no basis for concluding that a general policy of actively promoting or discouraging international investment would further the U.S. national interest.

-- Third, unilateral U.S. Government intervention in the international investment process could prompt counteractions by other governments with adverse effects on the U.S. economy and U.S. foreign policy.

-- Fourth, the United States has an important interest in seeking to assure that established investors receive equitable and non-discriminatory treatment from host governments.

It is important to understand that while this policy is consistent with the long-standing national commitment of the United States to an open international economic system, it is primarily based on a pragmatic assessment

of the national self interest of the United States. We have an open door for foreign investment in this country, not as an accommodation to foreigners or their governments but because such new investment provides important benefits to our own economy.

Our need for new investment is particularly apparent at present. We need more jobs, more productive capacity, and more new technology to minimize the level of unemployment. We need more exports and more capital inflows to help improve our balance of payments and strengthen the dollar. We need more investment and more competition to help fight inflation.

Our ability to achieve these objectives is directly dependent on the willingness and ability of private companies and individuals to put up money at risk, to gamble on the future. There is no surplus of such people, in the United States or the world as a whole. Not enough of them are prepared to "take the plunge" of new investment to meet our needs for the next decade and beyond. The notion of discriminatin against investors simply on the basis of where they come from has never had any economic rationale, and in today's economic environment it would be at cross purposes with our highest priority domestic economic objectives.

In the interdependent world of today, it is apparent that investors from abroad have much to offer to help us meet our economic goals -- just as U.S. investors have helped other countries throughout the postwar period to meet their

goals. In fact, the United States is still investing far more in the rest of the world in the form of private investment than is being invested here, in spite of the fact that foreign investment here has picked up substantially in recent years. In 1978, for example, the outflow of U.S. direct investment abroad of $16.7 billion was over twice as great as the $6.3 billion inflow of foreign direct investment here. In the first quarter of this year, the outflow was over four times the amount of the inflow.

Since the early 1970's, concerns have occasionally been expressed about foreign investment in the United States. However, I am not aware that the perceived problem has ever been precisely articulated. The concerns appear to be based, in large part, simply on the size of foreign investment in the United States -- particularly those investments where foreigners exercise control over, or a major influence in, U.S. companies, i.e., direct investments. But the fact of the matter is that the magnitude of this investment is insignificant in relation to the size of the U.S. economy.

Perhaps the best indicator for this purpose is the proportion of total U.S. output which is accounted for by foreign-owned companies. The Commerce Department has estimated that value added by U.S. affiliates of foreign firms accounted for only 2.2 percent of total value added for the U.S. economy as a whole in 1974. We estimate that the figure

increased to about 2.6 percent in 1977, the latest year for which sufficient detail for this purpose is available. OPEC direct investment, which has been of particular concern to this Committee, accounts for less than one percent of total foreign direct investment and an infinitesimal fraction of total U.S. value added.

It is sometimes suggested that we should restrict investments in specific companies or industries but, to the best of my knowledge, the basis for such restrictions has never been articulated either. In fact, I am not aware that anyone has ever identified one single instance of a foreign direct investment in this country which should have been blocked or should now be rescinded.

I have dealt at some length with our policy on foreign investment and the current status of foreign investment here because they provide the policy basis underlying the existence of the CFIUS, how it operates, and what it should or should not be doing at the present time. The key points in this regard are:

-- We have an open door policy toward foreign investment because this investment is beneficial to our economy.

-- The size of foreign investment in this country is not significant in relation to our overall economy.

-- We are not aware of any individual foreign investment which anyone contends should have been blocked, or should now be reversed.

Committee on Foreign Investment in the United States

In addition to reviewing overall U.S. policy toward foreign direct investment, the new Administration in early 1977 reviewed the Committee on Foreign Investment in the United States, which had been established by the previous administration, and decided that it was a useful procedure and should be continued. The Committee was set up by Executive Order 11858 of May 7, 1975, which stipulated that an interagency committee, headed by the Treasury Department and including representatives from the Departments of State, Defense and Commerce, should monitor the impact of foreign investment in the United States and coordinate the implementation of U.S. policy on such investment.1/ In particular, the Order stipulated that the Committee should:

1/ From its inception CFIUS has drawn a distinction between foreign investments in the United States which are of a medium and long-term nature and placements of funds in liquid balances or short-term securities for purposes of cash or reserve management. CFIUS has never considered that its responsibilities should extend into the area of such liquid foreign dollar holdings, which result in large part from the international role of the dollar as the primary international reserve and intervention currency.

Accordingly, it has viewed its responsibilities in the area of portfolio investment as limited to foreign purchases of U.S. equities involving less than 10% ownership by the foreign investor and of debt instruments with maturities of more than one year. This was also the definition of portfolio investment employed in both the 1974 Benchmark Survey and the Survey currently under way.

1. Arrange for the preparation of analyses of trends and significant developments in foreign investments in the United States;
2. Provide guidance on arrangements with foreign governments for advance consultations on prospective major foreign governmental investments in the United States;
3. Review investments in the United States which, in the judgment of the Committee, might have major implications for United States national interests; and
4. Consider proposals for new legislation or regulations relating to foreign investment as may appear necessary.

The second and third of these functions, the provisions for consultation and review in the case of certain investments, are particularly noteworthy. These provisions did not at the time of the Order, nor do they now, constitute a departure from, or an exception to, the long-standing U.S. open door policy toward foreign investment. The United States did not then, and does not now, object to direct investment here by foreign governments *per se*.

These new provisions, however, were devised as a response to the new situation which has arisen as a result of the

OPEC surpluses. While the governments of those countries said that they had no desire to take over any major U.S. companies, this contingency had to be recognized as a possibility given the necessity for those governments of finding investment outlets for their surplus funds. Such investments raise a question in the minds of some of political motivation. The previous Administration therefore set up the new procedures, and they have been continued by this Administration.

A second key reason for the new procedures was to dispel uncertainty in the minds of foreign investors concerning U.S. policy. Investors, particularly if they are governments, do not want to invest where they feel they are not welcome and some of the statements being made about inward foreign investment at that time raised doubts in this regard on the part of potential foreign investors.

Therefore, in announcing the formation of the CFIUS to a Senate committee on March 4, 1975, Under Secretary of the Treasury Jack F. Bennett stated:

> It is our belief that the policy and arrangements we are proposing will simultaneously safeguard our national interest and, by clarifying the situation, actually enhance the attractiveness of the United States for foreign investors.

It should be stressed that the CFIUS was not designed to establish new entry requirements for foreign investment in the United States. It exists and operates entirely within the context of basic U.S. policy on foreign investment, as described above. It is not authorized to change this policy. The consultation and review procedures of the CFIUS constitute an orderly procedure for handling contingencies, to assure that any actions or inactions by this Government in regard to foreign investments in this country are based on carefully considered judgments of what is in the national interest.

The guidelines for the operation of the CFIUS, which were officially adopted by the Committee in June 1978, have been carefully drawn up in this context. The introduction to the guidelines reiterates that the Committee was formed "in response to Congressional and public concern about potential threats stemming from investments by OPEC countries," and that it had been decided to ask all governments planning investments here to consult with the U.S. Government beforehand and to create a new office in the Commerce Department to monitor individual investments more closely.

The guidelines state that upon receiving a notification by a foreign government of a proposed investment, the chairman will make an initial decision as to whether the investment

warrants a formal review by the Committee. If he concludes that such a review is not necessary, he will circulate to the other members of the Committee information on the investment and his recommendation on a response. If the other members concur, he will send a letter to the appropriate foreign government official stating that the Committee decided not to review the proposed investment and that no further consultations will be necessary.

If a member of the Committee believes that a proposed investment might have major implications for the national interest, the chairman will convene a meeting of the Committee to formally review it. The basic presumption for any such review is that the proposed investment does not have major adverse implications for the national interest and the burden is on any member who thinks otherwise to so demonstrate. In the absence of such a demonstration, the conclusion of the review is that the Committee has no objection to the investment.

If the Committee concludes that an investment would have major adverse implications for the national interest, the chairman will communicate this conclusion to the Economic Policy Group and to the National Security Council and request the concurrence of these bodies in a notification to the foreign government involved through the appropriate channel requesting the government to refrain from making the investment or to modify it in such a manner as to make it acceptable to the USG.

The Committee has no legal power to block or modify investments, but in the case of investments by foreign governments we are confident that diplomatic representations would suffice. Even in the case of an investment by a private foreign investor a strong negative reaction by the U.S. Government would probably be sufficient to stop it.

Regarding more specific points, the introduction to the guidelines notes that the Committee has consciously avoided the formulation of criteria for judging "major implications for United States national interests" since the possible considerations involved are sufficiently numerous that judgments are best made on a case-by-case basis.

The Committee has also refrained from defining the kinds of prospective investments by foreign governments of which the latter should notify the Committee, or from stipulating the timing of notification by foreign governments. Thus, in a cable instructing all our foreign posts of the new procedure in 1975, it was stated only that "We expect foreign governments that are contemplating major investments in the U.S. to consult with us on such investments." (Another cable was sent to the field in July 1978, reiterating the basic policy and CFIUS procedures and conveying the new guidelines to them.)

That cable also stated that portfolio investments are excluded from the procedure: "Advance consultations will not be expected in cases of diversified portfolio investments in U.S. corporate securities even though aggregate amount by foreign governmental investor may be substantial. Nor do foreign governmental investments in U.S. Government securities fall within these terms of reference."

The reason for excluding portfolio investments from the notification procedure was that these investments, by definition, do not give the investor control of, or a major influence in, the companies whose securities are being purchased. There is, of course, no clear dividing line in terms of amounts or percentages as to what is or is not a controlling or major interest in a company. This will vary on a case-by-case basis. Any attempt to draw a line for purposes of the notification procedure, therefore, would be either so low as to inundate the CFIUS with countless notifications from foreign official agencies of inconsequential purchases or so high as to exclude some investments which we might consider significant enough to warrant notification.

Since foreign governments have every reason to respect our desire for notification of significant investments and are capable of making a common sense judgment of what we are after, we see no need to try to devise some arbitrary line to define portfolio investments.

The guidelines further state that, while it is considered unlikely that any private foreign investments would be viewed as having major implications for the national interest, the possibility of the Committee reviewing such investments could not be excluded for two reasons. First, it would be difficult, if not impossible, to establish criteria for determining what constitutes a government investment. Many foreign governments have varying kinds and degrees of participation in enterprises in their countries and it is not possible to draw a meaningful line in the abstract to distinguish between "private" and "government" investments. Second, such a limitation would have unduly circumscribed the purview of the Committee and, by implication, that of the U.S. Government.

In regard to the procedure for consultations and review, the guidelines state that the Committee should avoid reviewing investments which do not have "major implications" for the national interests. The mere fact that the Committee is reviewing or has reviewed a particular investment may be interpreted as an implication that the U.S. government is less than neutral on the investment and on foreign investment generally. Also, the more cases the Committee reviews the more it will come to be viewed as a general screening mechanism.

Consultations with governments can range from mere notification by a foreign government of a prospective investment to detailed discussions between the two governments, depending on the nature of the case involved. We want governments to notify us of prospective investments only if they are significant enough, in the opinion of the foreign government, to be brought to our attention. The timing of the notification is also left to the foreign government involved.

I want to emphasize, however, that this does not mean that we leave the final decision in these respects to foreign governments. If at any time we became aware of an investment which we felt was significant and of which we had not been notified by the foreign government involved, we would request consultation with that government immediately. Thus, we leave the decision as to whether and when a foreign government should notify us to the discretion of the foreign government only in the first instance.

This is the only practical way to proceed, in our opinion. Foreign governments recognize that they must respect the policies of the U.S. government in regard to their activities in the United States. Thus, it would not be in their interest to consciously avoid notifying us of a significant investment which

they were contemplating. On the contrary, consultations on such investments are in their interests since the procedure provides a means to discover and deal with any difficulties that might arise before they become substantially committed to an investment.

As to the timing of any notifications, any arbitrarily set time period would not be useful because situations vary among individual investors. Some investors may want to know at an early stage what USG views are to avoid the possibility of wasting time, money and effort on an investment which we would not welcome. Other investors might want to keep their intentions confidential until shortly before the effective date of the investment, for legitimate business reasons. While we would hold in confidence any information given us by a foreign government on a prospective investment if it so requested, the more broadly information is disseminated, the more the concern of the investor that it will leak. Thus, a requirement that might force investors into premature disclosures of their intentions could have an undesirable deterrent or distortive effect on foreign investments in the United States.

The fact that the CFIUS has no legal power to block or modify foreign investments may not be generally known because there is a misconception that the CFIUS is a kind of regulatory body for foreign investment in this country. Foreign investment

in the United States is regulated -- but not by the CFIUS, and not in ways different from the regulation of investment by Americans in this country, with a few exceptions.2/

Those who express concern about potential abuses or misuses of U.S. companies which are owned by foreigners overlook the fact that we have many laws and regulations on the books which can cover all such potential abuses -- and that these laws are equally applicable to U.S. and foreign owned companies operating in this country. If there are additional potential abuses of U.S. companies which are a real threat to the national interest, we should have laws against them regardless of whether such actions are perpetrated by foreigners or by Americans. There would seem to be no basis for a presumption that certain actions by foreign owned companies could be against the national interest even though the same actions by U.S. owned companies would be acceptable.

Therefore, the regulation of foreign owned companies, along with that of U.S. owned companies, is properly left to the appropriate regulatory authorities. The Executive

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2/ See question III (2) in appendix for the exceptions.

Order establishing the CFIUS specifically stated that nothing in the Order should in any way supersede or prejudice any other process provided by law.

These remarks, Mr. Chairman, cover what I believe are the key features of U.S. investment policy and of the operations of the CFIUS. They respond to some of the specific questions you asked me in your letter of invitation of July 18. The other specific questions in that letter are answered in the appendix to my testimony.

New Legislative Authority?

There was one question in particular, however, which I want to respond to here because I think it goes to the heart of our basic policy on foreign investment. You asked whether CFIUS should be given more authority to regulate foreign investment, either by legislation or by executive order; whether it should be reconstituted; and what recommendations, if any, would I have.

My response is that the CFIUS should not be given such additional authority, for several reasons. First, there is no need for such authority. Second, the establishment of such authority in and of itself would tend to discourage foreign investment here. Third, the mere existence of the authority would significantly increase the possibility

of foreign investments being blocked or delayed for reasons unrelated to the national interest. Finally, the creation of such authority could have unfortunate repercussions for U.S. investment abroad and for the international investment climate in general.

As I have stated, the specter of a spate of foreign takeovers of U.S. companies was raised as far back as 1973. Since that time, however, there has not been one instance in which we needed any special authority to protect the national interest against an unwanted foreign investment. The share of foreign investment in our total capital stock remains extremely small.

Moreover, we are confident that, in the case of investments by foreign governments, diplomatic representations would suffice to stop any investment of which we disapprove. We are also confident that a strong negative reaction by the U.S. Government would be sufficient to stop an unwanted investment by a private foreign person. Admittedly, government disapproval unsupported by law is not an air-tight safeguard and it is theoretically possible that an unwanted foreign investment could slip between the cracks. But the possibility of such a contingency, based on our actual experience to date, is _de minimus_.

We also want to make sure that we do not discourage foreign investment here inadvertently or intentionally. The establishment of new authority by law for the CFIUS to block foreign investments would be highly visible to potential foreign investors in

the United States, and would be taken as a sign that our nation is changing its basic and traditional attitude toward such investment. Whatever the validity of such a conclusion, it is clear that perceptions of the host government's attitude toward foreign investment are an important factor in investors' decisions as to whether to invest in a given country.

Direct investments in this country frequently represent substantial sums of money and are made for the long term. They are not quick, in-and-out propositions. Therefore, those who make such investments must look down the road five, ten or even more years and make a judgment as to whether this country will continue to be a hospitable environment for their investments. A move on our part, for the first time in U.S. history, to establis authority to restrict foreign investments on a case-by-case basis obviously would bode ill in the minds of investors for the long term outlook for the investment climate in this country. If we are prepared to restrict entry of foreign companies today, tomorrow we might even be prepared to restrict the operations of foreign companies who have already come in.

Such a move would also pose a significant negative factor in investment decisions in the short run. Foreign investors would have to take account of the possibility that an investment might be disapproved after they had gone to the expense involved in making the decision to invest here, which can be considerable in the case of large investments.

In addition to having a chilling effect on foreign investment here, I believe that the establishment of legal authority to restrict foreign investment, even if there were no mandate of any kind to use it, would be a step down the road to restrictions. The creation of authority creates a presumption that it should be used. An act of Congress signed by the President would, by definition, be based on the proposition that there is a new danger to the Republic which requires a new safe-guard. Hence, it would be an open invitation to pressures to use it for reasons unrelated to the national interest, although they would, of course, always be put forward under this guise. The "national interest" is not always clearly identifiable, of course, and judgments in this area can be highly subjective.

My final reservation about the establishment of such authority is that it would be the wrong signal to send to other governments. It would tend to justify current and future restrictions on entry and operations of foreign investors (including U.S. companies) in other countries, in ways clearly detrimental to our national interest in an open world economy.

While the United States does not establish patterns of behavior for other countries, our actions and the perceptions of our intentions do affect the thinking of other governments in the international economic area. This is particularly true in the case of international investment, because U.S. investment has traditionally dominated international capital flows and U.S. firms still account for close to one-half of all foreign direct investment in the world -- a far greater ratio than our share of world trade, monetary reserves or in fact any other key international economic indicator.

If the United States -- the primary "keeper of the faith" for an open international economic system -- were to appear to be moving down the road toward restrictions, this would have a major corrosive effect on other countries and tend to legitimize current and new interventions in international investment on their part. While the United States would, of course, portray any such new legislation on its part as necessary in the national interest, all governments portray their interventions as vital to their national interest. And this justification would be particularly lacking in credibility in our case, since we would be unable to point to one single instance to demonstrate the need for such protection.

We cannot isolate our actions from the actions of other governments, and foreign investment in the United States must be viewed in relation to our investment abroad. U.S. direct investment abroad stands at $172 billion (as of last March), which is more than four times the $41 billion of direct investment here. We would clearly risk losing much more than we would gain if we did anything to legitimize government interventions in international investment.

It is true that many other governments maintain restrictions on inward and outward investment. But, on the whole, borders are much more open to international investment than they were twenty or even ten years ago. Fears about foreign direct investment, which bordered on paranoia in some countries just a few years ago, have been receding rapidly. This is due importantly to the continuing efforts of the United States -- efforts which could hardly continue if we began to restrict incoming investments ourselves.

A more recent and more subtle problem in this area is the tendency of some governments to try to steer the locations and operations of multinational firms, in order to tilt the benefits of international investment in their direction at the expense of other countries. Indeed many countries now offer incentives to attract foreign investments into their economies. This Administration has mounted a major

effort in multilateral forums and bilaterally to reverse this trend, so that market forces can continue to play the major role in determining investment flows abroad as well as at home.

We are making some progress in this area, though any major initiative toward international reform in this area will take many years to bring to fruition. However, we cannot afford to take unilateral actions which would set back the effort to assure that we and the rest of the world share the benefits of international investment fully and fairly.

ANNEX

Response to the Subcommittee's Questions
in the letter to Mr. Bergsten
of July 18, 1979

Introductory Remarks

The questions listed in Congressman Rosenthal's letter of July 18, 1979, are keyed on the several specific responsibilities of the CFIUS as stated in Executive Order 11858 (which is attached to this statement). The basic purpose of these questions, as we understand it, is to help the Committee determine whether these responsibilties are being fully and properly met by the Executive Branch. In addressing this question, it is important for the Committee to have a clear understanding of how this Administration interprets the responsibilities laid out in the Order.

The key point, on which there may be some misunderstanding, is that the Order did not mandate a new policy with regard to foreign investment. Rather, it was designed to create an orderly procedure to assure that any necessary functions in regard to the foreign investment policy which is traditional in the United States and which has been reaffirmed by the previous and current administrations, as outlined in the main body of my statement, are carried out fully and in an orderly manner. For this purpose it established the CFIUS, consisting of representatives of specific agencies, to make clear who in the Executive Branch has these responsibilities.

Thus, the test of whether the CFIUS is fulfilling its responsibilities is not how much activity it has generated, on its own part or on the part of others, but the extent to which the necessary functions are being carried out within the Government to effectively implement U.S. policy toward foreign ivestment in the United States.

PART I

1. QUESTION: What has CFIUS done to monitor the impact of foreign investment? Has it been involved in any aspects of Federal data collection efforts, and if so, what aspects and when? Has it coordinated data collection efforts by Treasury, Commerce and other agencies? Has it set priorities as to what type of data should be collected and provided directions to match these priorities with data collection efforts? If so, what priorities has it set and how have these been implemented?

ANSWER: Comprehensive analyses of the impact of foreign investment in the United States - both direct and portfolio - were published by the Commerce and Treasury Departments respectively in 1976 in accordance with the Foreign Investment Study Act of 1974. In January 1979 the Commerce Department published in its

Survey of Current Business an analysis of the gross product of U.S. affiliates of foreign companies in relation to total gross product of all companies in the United States.

These studies constitute the basis or benchmark from which we monitor the significance of foreign investment to the U.S. economy on a current basis. This is done on a continuing basis by my staff at the Treasury, by the Bureau of Economic Analysis (BEA) and the Office of Foreign Investment in the United States (OFIUS) at the Commerce Department, and by the Department of Agriculture in the case of real estate. CFIUS does not review in detail the impact of foreign investment unless a policy issue arises in this regard, such as in the case of the petroleum industry (in connection with the Iran/Occidental investment) or farmland. Rather, the CFIUS reviews the latest trends in a general way to see if there are any developments which raise policy issues.

The CFIUS has been involved in federal data collection efforts on occasion. In 1976 it coordinated the Executive Branch

position on the International Investment Survey Act of 1976, and in 1978 it discussed the U.S. Government's collection of data on foreign investment in U.S. farmland. Also, on July 20, 1979, as Chairman of the CFIUS I sent a memorandum (attached) to the Comptroller of the Currency requesting his cooperation with the OFIUS in getting information on foreign investment in the banking secto

The primary group for coordinating data collectio efforts is the Office of Federal Statistical Policy and Standards, which was created by this Administration. This office holds meetings of representatives from all government agencies which have a policy interest or technical function in regard to data collection in order to set priorities for data collection in accordance with policy needs, technical feasibility, and available funds. The participants in those meetings who are concerned with data needs in connection with our policy on foreign investment in the United States are satisfied that current data collection efforts are adequate for this purpose. If there should be major disagreement in this respect, this disagreement would be brought up in the CFIUS.

A prime example of a new data collection effort in regard to foreign investment in the United States which was reviewed and agreed to by the Federal Statistical Policy office is the Commerce Department's new BE-13 report form requiring the reporting of the establishment or acquisition of a 10% or more equity interest in a U.S. business enterprise by a foreign person, where the value of the enterprise is more than $500,000, or the purchase of 200 acres or more of land. Purchase of an operating segment of a U.S. business enterprise is also covered. This report is required for investments occurring on or after January 1, 1979. It goes considerably further than previous reports on foreign investment in the United States, since it includes newly established enterprises and acquisitions of American companies that are not publicly held.

2. QUESTION: Closely related, what actions has CFIUS taken to coordinate implementation of U.S. policies? First, what policies have been formulated by

CFIUS to deal with foreign investment, including investments in the energy and other sensitive sectors? (We know that there is an attempt to formulate a policy on foreign investment in energy in late 1976; did CFIUS ever formulate such a policy?) Secondly, how do these policies relate to CFIUS' review of investments, covered in question #5 below?

ANSWER: Coordination of policy on foreign investment is primarily a matter of day-to-day implementation. It is carried out by policy and staff level officers of the CFIUS agencies in their contacts with other U.S. Government officials and foreign government officials. The only occasions for CFIUS to concern itself with policy coordination are when there are major questions as to whether certain actions by the USG are or would be in conflict with basic policy and whether an exception to the policy would be justified.

There have been three occasions on which CFIUS has discussed policy coordination:

(1) On October 24, 1975, in regard to the International Energy Agency's Long-Term Cooperation Agreement; (2) in September 1976, in regard to an FEA proposal (see below); (3) on June 15, 1978, in regard to farmland (see below).

As to formulating policies, as I stated in the main body of my statement, our policy on foreign investment is given in the July 1977 policy statement and CFIUS has no authority to change this policy. The CFIUS would, of course, make recommendations for changes in policy if it felt any were needed.

One such suggestion was made by the Federal Energy Administration (FEA) in 1976 during the previous administration. The FEA maintained that U.S. policy might not be valid for energy and, therefore, that investments in that sector might require special treatment and safeguards. The issue was examined by a CFIUS working group, which reached the conclusion that there was no

justification for singling out energy as FEA had suggested.

Last year, the CFIUS reviewed the case for special restrictions on foreign investment in farmland. As I reported in my statement to a House subcommittee, our general approach was unanimously reaffirmed in that case as well although we supported a more intensive effort to collect comprehensive data regarding foreign investment in that sector. (A copy of that statement is attached for the Subcommittee's information.)

3. QUESTION: What analyses of trends and significant developments in foreign investments has CFIUS arranged to have prepared? 3/ Please list the documents constituting these analyses, indicating the date CFIUS requested each analysis, the subject of each and the conclusions of each. (At the time of the hearing, we would like all of these analyses presented to the subcommittee.)

ANSWER: As noted in the introductory remarks to this appendix, we do not consider it necessary for the CFIUS to perform or arrange for any functions regarding foreign investment if it considers that sufficient efforts in this regard are already being

carried out. Thus, the CFIUS has not arranged for analyses itself because we feel that analyses done and underway are sufficient. A list of these analyses is attached. It should be noted that statistical data alone are frequently sufficient to show "trends and significant developments in foreign investments" in the United States.

As to the conclusions of each of these analyses, many of them do not arrive at explicit conclusions and the individual conclusions in others are too varied and complex to list or be succinctly summarized. I would, however, be glad to supply the Committee with any conclusions or judgments on specific questions you may have regarding trends and significant developments in foreign investment in the United States.

Footnote #3

QUESTION: In his letter of October 14, 1977, to Assistant Secretary Daniel Brill, Senator Inouye set forth seven areas of concern involving foreign investment and suggested that the Committee on Foreign Investment be reconstituted, since it had not met in

over one year. Such concerns as foreign investment in banking, flight capital from Europe, foreign investments by Communist governments, among others, were listed as needing analysis. As to each of these what has CFIUS done? Was there a review of U.S. general policy towards foreign investment, as requested by Senator Inouye?

ANSWER: As we said in our reply to Senator Inouye and as I indicated at the beginning of my statement, this Administration undertook a review of U.S. policy on direct international investment soon after taking office -- several months before Senator Inouye sent us his letter. We informed Senator Inouye of this and sent him a copy of the policy statement that resulted from that review, the major points of which I have outlined in my statement.

The remaining questions Senator Inouye suggested that the Committee take up were dealt with in several ways: The questions he raised about the United States' following a policy of reciprocity or of encouraging

investments which involve advanced technologies or are labor intensive had been dealt with in our policy review; his question on foreign investment in U.S. real estate was taken up, in large part, by the CFIUS during its discussions of foreign investment in U.S. farmland; two questions related to hypothetical political developments in Europe that did not materialize; and the final two that concerned foreign investment in the U.S. banking and fisheries sectors, respectively, were handled through other interagency channels.

4. QUESTION: How has CFIUS fulfilled its mandate to provide guidance to foreign governments on the need for advance consultations? What guidance has it provided? When do advance consultations take place? Have there ever been any problems obtaining the cooperation of foreign governments, and, if so, when? More importantly, what kinds of prospective portfolio and direct investments by foreign governments require advance consultation? Have these been defined and made known to foreign governments?

ANSWER: In 1975 a State Department cable was sent to all American embassies abroad informing them of the establishment of the CFIUS and the new consultations procedures. The cable said, in part, "We expect foreign governments that are contemplating major investments in the United States to consult with us on such investments." The embassies were instructed to provide their host governments with copies of Executive Order 11858 and the press release issued at the time of the Committee's first meeting, both of which noted the new consultations procedure. In addition, my predecessor, Gerald L. Parsky, personally brought the new procedure to the attention of the major oil surplus countries in the Middle East, since these were the major potential governmental investors in the United States.

Thus far, all the governments involved in the cases the Committee has reviewed have cooperated fully in consulting with us on the investments in question.

The other parts of this question are covered in the main body of my testimony.

5. QUESTION: With regard to CFIUS review of investments in the U.S. having major implications for U.S. national interests, please answer the following questions: (a) Which types of investments in the U.S. fall within this category? What criteria and standards has CFIUS developed to determine when portfolio and direct investments have major implications for the national interests? What industry sectors are involved?

ANSWER: As noted in the main body of my testimony, the CFIUS has consciously avoided the formulation of such criteria because we do not feel they are necessary or practicable.

QUESTION: (b) What was the basis for excluding certain types of categories of foreign investment from the scope of review, as having no major implications for the national interest?

ANSWER: As I explained in my statement, we have excluded only diversified portfolio investments in U.S. corporate securities and foreign governmental investments in U.S. Government securities from the scope of the CFIUS review process.

QUESTION: (c) What investments has CFIUS reviewed, and, in each case, what was the scope of its review, when did each review occur, what was its determination, and what actions were taken?

ANSWER: The Committee has reviewed the following investments:

-- Government of Romania/Island Creek Coal Company: In July 1975 the Government of Romania signed a framework agreement with the Island Creek Coal Company, a subsidiary of Occidental Petroleum, which called for a $150 million joint venture to open a new coal mine in Virginia. The Committee held a preliminary discussion of the case on July 18. It was decided that the Romanian Ambassador should be contacted and given a list of questions relating to such matters as the level of Romania's coal imports from the United States, its plans for future investments here, and the nature of its participation in the venture.

The Romanian Ambassador called on my predecessor, Gerald L. Parsky, in August with his government's responses to the questions the U.S. Government had posed

and supplemented them orally. After consulting the other members of the CFIUS, Under Secretary of the Treasury Edwin H. Yeo, Chairman of the CFIUS at that time, sent the Romanian Ambassador a letter informing him that the Committee had concluded that no further consultations on the investment would be necessary and that the Committee had no objections to it. We understand that the final agreement was signed the following year and went into effect early in 1978.

-- Imetal/Copperweld: In early September 1975 a French Firm, Societe Imetal, made a tender offer for shares of the common stock of the Copperweld Corporation of Pittsburgh, Pennsylvania, which was opposed by Copperweld's management. The Committee's members initially became aware of the transaction as a result of press reports on the dispute, and the CFIUS became formally involved when the President of Copperweld wrote to Under Secretary Yeo, requesting that it

review the case on the grounds that the French Government was involved in the takeover and that it would be against the national interest. Government officials were also contacted by Congressmen on behalf of the President of Copperweld.

Consultations were held with the French Ambassador, who stated that his government was not involved in the management of Societe Imetal. Subsequently, the Committee met, on September 18, 1975, to discuss the case. Among the aspects of the case the Comittee considered were the question of French Government involvement and possible defense implications. The CFIUS concluded that it had no basis for interposing itself in the transaction and this conclusion was communicated to Mr. Smith. (The text of a statement by my predecessor, Gerald L. Parsky, to a House subcommittee which reviewed the CFIUS' involvement in this case is attached.)

-- Government of Iran/Occidental Petroleum Corporation: On June 21, 1976, the Government

of Iran and the Occidental Petroleum Corporation signed a letter of intent whereby Iran was to purchase 6,250,000 of cumulative voting preferred stock and an equal number of common stock warrants for a cash price of $125 million. The acquisition of the stock was to give Iran control of approximately 9 percent of Occidental's outstanding voting stock and the right to elect one member to the Corporation's board of directors. These were also conditions on exercise of the warrants. The final agreement was subject to the approval of the Occidental board and the appropriate U.S. and Iranian government authorities.

Discussions were held with the Iranian Ambassador and with officials of Occidental concerning the proposed transaction. The issues covered included the Iranian Government's intentions regarding control of the corporation, its reasons for undertaking the transaction, and the possibilities for future cooperation between the two parties.

The CFIUS met on July 7, 1976, to discuss the case. In addition to the information that had been received from the Iranian Ambassador and the Occidental Petroleum Corporation, the Committee discussed such issues as the implications of the transaction for future development of energy technology, the security of U.S. supplies and possible defense implications. No agency objected to the proposed transaction. The CFIUS concluded that it would have no major adverse implications for U.S. national interests and, therefore, there was no basis for U.S. Government intervention.

The Committee also decided that the proposed transaction should be reviewed elsewhere within the Executive Branch. This was in process when it was announced that the two parties had terminated their negotiations because of their inability to agree on the terms of the final agreement.

QUESTION: (d) How does CFIUS function? When does it meet? Can any Federal agency participate? Does a majority vote of CFIUS result in a determination of undesirability or do you have the final decision on this?

ANSWER: How CFIUS functions is discussed in the main body of my statement. As to the frequency of its meetings, the Committee does not meet periodically, but rather on an _ad hoc_ basis as the need occurs. Since its establishment, it has met eight times.

The Committee membership consists of representatives of the Departments of Commerce, Defense, State, and the Treasury. Other agencies with an interest in particular issues under discussion are also invited to attend.

As to the basis for decision, the Committee has never had to take a vote because it has always been able to arrive at a consensus on the issues before it. In the event that there were serious differences between the agencies that could not be resolved at the CFIUS level, the issue would probably be referred to the Economic Policy Group and to the National Security Council for resolution.

QUESTION: (e) What occurs if the investment is undesirable? What actions can CFIUS take to either prevent entry of an investment or to require changes making the investment more beneficial to the U.S.?

ANSWER: This is covered in the main body of my statement.

6. QUESTION: What new legislation or regulations relating to foreign investment, if any, has CFIUS considered? What position and actions did CFIUS take with respect to each?

ANSWER: As noted in my answer to question #1, the Committee has reviewed two legislative matters -- the International Investment Survey Act of 1976 and the issues related to foreign investment in U.S. farmland. On the 1976 Survey Act, the CFIUS discussed the proposed legislation and coordinated the positions of the Executive Branch agencies that were scheduled to testify on it. Regarding the farmland issue, the CFIUS (1) reaffirmed that there was no basis for departing from basic U.S. plicy on inward investment in this sector and agreed that I would be the lead witness for the Administration in pending hearings before a

House subcommittee and (2) discussed the Department of Agriculture's progress in conducting the study of the feasibility of establishing a system of monitoring foreign investment in U.S. farmland, as mandated in the Survey Act, and its implementation of the Agricultural Foreign Investment Disclosure Act of 1978.

7. QUESTION: And, finally, what periodic reports has CFIUS published? (At the time of the hearing, we would like these reports presented to the subcommittee.)

ANSWER: The CFIUS is not required to publish any reports itself and has not done so. The pertinent language in Executive Order 11858 is: "It (CFIUS) shall also arrange for the preparation and publication of periodic reports." (underlining supplied) Such reports are noted in the answers to questions number (1) and (3) above.

PART II

QUESTION: Would you please specify the dates on which CFIUS has met and set forth very briefly the topic(s) under discussion at each meeting.

ANSWER: May 20, 1975

(1) Draft press release on the formation of the Committee.

(2) Draft cable to U.S. embassies on the establishment of the Committee and procedures for consultations with foreign governments regarding their plans for investments in the United States.

(3) The arrangements that had been worked out to date with respect to advance consultations with foreign governments.

(4) Staffing and organization of the Commerce Department's Office of Foreign Investment in the United States.

(5) Letter from the Public Service Commission of the District of Columbia on a proposed foreign purchase of bonds and preferred stock of the Washington Gas Company.

July 18, 1975

(1) Government of Romania's proposed joint venture with the Island Creek Coal Company.

(2) U.S. position on the International Energy Agency's long-term cooperation program.

(3) Letter concerning the effects of Opinion No. 17 of the Accounting Practices Board on foreign investment in the United States.

<u>September 18, 1975</u>

Proposed acquisition of the Copperweld Corporation by Societe Imetal.

<u>October 24, 1975</u>

International Energy Agency Long-Term Cooperation Agreement.

<u>February 20, 1976</u>

S.2839, the "International Investment Survey Act of 1975."

<u>July 7, 1976</u>

Proposed investment by the Government of Iran in the Occidental Petroleum Corporation.

<u>June 15, 1978</u>

(1) Committee procedures, including approval of new operating guidelines and transmission of cable to all overseas posts reiterating basic U.S. policy and conveying the guidelines.

(2) Report by the Office of Foreign Investment in the United States on current trends in foreign investment transactions.

(3) The Department of Agriculture's work regarding monitoring foreign investment in farmland pursuant to Section 4(d) of the International Investment Survey Act of 1976.

<u>January 22, 1979</u>

(1) Current developments with regard to foreign direct investment in the United States.

(2) Status of new surveys on inward investment being undertaken pursuant to the International Investment Survey Act of 1976.

(3) The Agriculture Department's efforts to implement the Agricultural Foreign Investment Disclosure Act of 1978 and Section 4(d) of the International Investment Survey Act of 1976.

(4) U.S. policy and U.S. embassy activities with respect to foreign direct investment in the United States.

<u>PART III</u>

(1) QUESTION: Apart from the issue of whether CFIUS is operating effectively and carrying out its mandates, we would like to know whether CFIUS should be given more authority to regulate foreign investment, either by legislation or executive order? Should it be reconstituted? What recommendations, if any, would you have?

ANSWER: These issues are thoroughly discussed in the main body of my statement.

(2) QUESTION: With the exception of certain laws, passed at different times in the past, prohibiting varying degrees of foreign investment in certain sectors of the U.S. economy, all of which were specified in an October 7, 1977, GAO report, what existing laws could be invoked to prevent an investment from taking place, to regulate it once it occurred, or to exact certain conditions (such as performance requirements) prior to approval? And how are any such laws carried out? Would you have recommendations for further legislation or regulation to regulate foreign investment in one of these ways?

ANSWER: As you note, many of these laws are described in the GAO Report entitled "Controlling Foreign Investment in National Interest Sectors of the U.S. Economy". Other laws are outlined in a Treasury Department publication entitled "Summary of Federal Laws Bearing on Foreign Investment in the United States." Treasury issued this Summary in 1975, and will shortly publish an updated version.

As both the GAO Report and the Treasury Summary indicate, there are many laws which bear on the activities of foreign investors in the

United States. Some of these laws regulate entry into particular sectors or industries. For example, in addition to the sector limitations described in the GAO Report, U.S. laws restrict alien or foreign investor participation in the telegraph industry, geothermal steam development, banking, fishing, and shipping in U.S. waterways or the coast-wide trade. Other laws, we note, exclude foreign investors from certain insurance, loan and subsidy programs.

More important are laws of general application which are not directly aimed at foreign investment, but regulate foreign investment in the same manner as domestic investment. Examples include the tax, antitrust, securities, and trade laws, which are summarized in both the Treasury Summary and the GAO Report.

I would note that the President also has authority under the International Emergency Economic Powers Act to regulate or prohibit any "acquisition" or "use of any property in which any foreign country or national thereof has any interest." The President may

exercise this authority to deal with an unusual and extraordinary external threat to the national security, foreign policy or economy of the United States.

As to any authority to exact certain conditions, such as performance requirements, our impression, based on our survey of U.S. laws, is that Congress did not intend, in any licensing statute, to impose such requirements on foreign investors. Rather Congress legislated specifically when it wished to impose requirements linked to the "nationality" of an investor. For example, in several statutes Congress has imposed specific requirements that board membership or management must consist of U.S. citizens. On the basis of our limited research to date, we thus do not believe that U.S. laws would authorize the Administration to impose what are traditionally thought to be performance requirements in respect of a new foreign investment.

Finally, as discussed in the main body of my testimony, I do not think any such new measures are necessary or desirable.

(3) QUESTION: If it is your contention that certain treaties with foreign governments would prohibit the regulation of foreign investment, either at time of entry or after entry, would you please provide in the appendix to your testimony the relevant passages from all such treaties. Do the countries involved regulate foreign investment in a manner different from the United States, and, if so, how?

ANSWER: We do not contend that treaties with foreign governments would prohibit the regulation of foreign investment. As noted in the main body of my testimony, we are opposed to such regulation because we believe that it would be contrary to our national self interest.

Foreign Investment in the United States

By virtue of the authority vested in me by the Constitution and statutes of the United States of America, including the Act of February 14, 1903, as amended (15 U.S.C. 1501 et seq.), section 10 of the Gold Reserve Act of 1934, as amended (31 U.S.C. 822a), and section 301 of title 3 of the United States Code, and as President of the United States of America, it is hereby ordered as follows:

SECTION 1. (a) There is hereby established the Committee on Foreign Investment in the United States (hereinafter referred to as the Committee). The Committee shall be composed of a representative, whose status is not below that of an Assistant Secretary, designated by each of the following:

(1) The Secretary of State.
(2) The Secretary of the Treasury.
(3) The Secretary of Defense.
(4) The Secretary of Commerce.
(5) The Assistant to the President for Economic Affairs.
(6) The Executive Director of the Council on International Economic Policy.

The representative of the Secretary of the Treasury shall be the chairman of the Committee. The chairman, as he deems appropriate, may invite representatives of other departments and agencies to participate from time to time in activities of the Committee.

(b) The Committee shall have primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment. In fulfillment of this responsibility, the Committee shall:

(1) arrange for the preparation of analyses of trends and significant developments in foreign investments in the United States;

(2) provide guidance on arrangements with foreign governments for advance consultations on prospective major foreign governmental investments in the United States;

(3) review investments in the United States which, in the judgment of the Committee, might have major implications for United States national interests; and

(4) consider proposals for new legislation or regulations relating to foreign investment as may appear necessary.

(c) As the need arises, the Committee shall submit recommendations and analyses to the National Security Council and to the Economic Policy Board. It shall also arrange for the preparation and publication of periodic reports.

SEC. 2. The Secretary of Commerce, with respect to the collection and use of data on foreign investment in the United States, shall provide, in particular, for the performance of the following activities:

(a) The obtainment, consolidation, and analysis of information on foreign investment in the United States;

(b) the improvement of procedures for the collection and dissemination of information on such foreign investment;

(c) the close observation of foreign investment in the United States;

(d) the preparation of reports and analyses of trends and of significant developments in appropriate categories of such investment;

(e) the compilation of data and preparation of evaluations of significant investment transactions; and

(f) the submission to the Committee of appropriate reports, analyses, data and recommendations relating to foreign investment in the United States, including recommendations as to how information on foreign investment can be kept current.

SEC. 3. The Secretary of the Treasury is authorized, without further approval of the President, to make reasonable use of the resources of the Exchange Stabilization Fund, in accordance with section 10 of the Gold Reserve Act of 1934, as amended (31 U.S.C. 822a), to pay any of the expenses directly incurred by the Secretary of Commerce in the performance of the functions and activities provided by this order. This authority shall be in effect for one year, unless revoked prior thereto.

SEC. 4. All departments and agencies are directed to provide, to the extent permitted by law, such information and assistance as may be requested by the Committee or the Secretary of Commerce in carrying out their functions and activities under this order.

SEC. 5. Information which has been submitted or received in confidence shall not be publicly disclosed, except to the extent required by law; and such information shall be used by the Committee only for the purpose of carrying out the functions and activities prescribed by this order.

SEC. 6. Nothing in this order shall affect the data-gathering, regulatory, or enforcement authority of any existing department or agency over foreign investment, and the review of individual investments provided by this order shall not in any way supersede or prejudice any other process provided by law.

GERALD R. FORD

THE WHITE HOUSE,
May 7, 1975.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

JUL 20 1979

MEMORANDUM FOR John G. Heimann
Comptroller of the Currency

Subject: Improvement of Information on Foreign Investment in the U.S. Banking Sector

I recently received a memorandum (copy attached) from Milton A. Berger, Director of the Commerce Department's Office of Foreign Investment in the United States (OFIUS) concerning the improvement of information on foreign investment in the U.S. banking sector. He has written to me in my capacity as Chairman of the interagency Committee on Foreign Investment in the United States (CFIUS) to ask for the Committee's endorsement of and assistance on a proposed study toward this end to be undertaken in cooperation with the regulatory agencies with jurisdiction over the banking sector. According to the memorandum, you chair the Federal Financial Institutions Examination Council, which coordinates the efforts of these agencies.

The CFIUS and the OFIUS were established under Executive Order 11858 in May 1975. Pursuant to that order, the CFIUS has responsibility for coordinating U.S. policy on inward investment. The OFIUS is charged with collecting and analyzing information in this area, and with recommending to the CFIUS means for keeping information on foreign investment current. The CFIUS has given a high priority to obtaining good data on inward investment in view of the contribution that it makes to the policy-making process in this area.

I believe that the effort outlined by Mr. Berger in his memorandum would move us a long way toward improving our data on foreign investment in the U.S. banking sector. Accordingly, this is to request that you ask the Federal Financial Institutions Examination Council to work with the OFIUS along the lines Mr. Berger suggests.

(Signed) C. Fred Bergsten

C. Fred Bergsten

Attachment

UNITED STATES DEPARTMENT OF COMMERCE
Industry and Trade Administration
Washington, D.C. 20230

22 JUN 1979

MEMORANDUM FOR C. Fred Bergsten, Assistant Secretary of the Treasury for International Affairs Chairman, Committee on Foreign Investment in the United States

SUBJECT: Improved Federal Financial Regulatory Agency Data on Foreign Investment in the United States

The Office of Foreign Investment in the United States has been meeting over a number of months with officials of federal agencies to improve the quality, expand the coverage, and facilitate the transmission to OFIUS of data on foreign direct investments here. Our effort represents a periodic stocktaking of existing arrangements and its need is underscored by recent Congressional concern and GAO investigations of data gaps in national interest sectors and banking. Fred Cutler of the Office of Federal Statistical Policy and Standards and Kelly Kuwayama of the SEC are participating in the meetings.

At this point we are meeting with the financial institution regulatory agencies -- the Federal Reserve Board, Comptroller of the Currency, FHLBB and the FDIC. Our initial contacts with these agencies took place three years ago at the time of the formation of our office when we had a series of meetings with the various agencies identified in the Price Waterhouse report on Federal Government agency sources of data on foreign investment in the United States, which was included in Commerce's 1976 Report to Congress. The Price Waterhouse report identified the available data and the gaps and recommended actions to secure and improve data. We made arrangements to secure such data as were available under existing laws and regulations and established on-going personal contacts. We suggested administrative changes to facilitate improved data collection, but did not press, however, for legislative or regulatory changes, accepting the judgment of the agencies that the available knowledge of foreign ownership was adequate to policy needs

and that the additional data that might be secured by such changes would not justify the legislative difficulties, the increased burdens on financial institutions, and the diversion of staff time at the regulatory agencies from current priorities. Even with respect to foreign ownership data that were being collected there are some retrieval problems involving costs which agencies have been unprepared to bear.

The time is propitious for a fresh examination of the problem with policy direction via the Committee on Foreign Investment in the United States. Coupled with the heightened Congressional and public interest in foreign investment in the banking sector, the financial institution regulatory agencies are now in the process of developing regulations and procedures to implement the International Banking Act and the Financial Institutions Regulatory and Interest Rate Control Act of 1978. The latter established a coordinating mechanism among the financial regulatory agencies, called the Federal Financial Institutions Examination Council. The Council is comprised of representatives of the Federal Reserve Board, the Federal Home Loan Bank Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the National Credit Union Administration, and is currently chaired by the Comptroller.

OFIUS's mandate requires us to make a vigorous effort to seek more and better data. While we seek to exercise some reasonable restraint, we require help in defining the needs and objectives in this sector and then in requesting the financial institution regulatory agencies to take appropriate steps to meet these objectives.

We perceive our banking sector data objectives as follows:

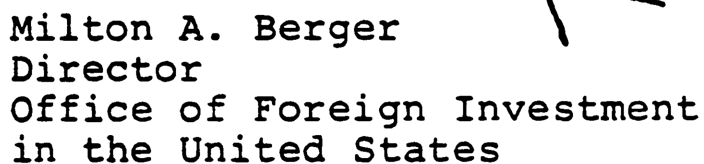
1. Maximize reporting of foreign ownership in applications and periodic reports by applicants and existing financial institutions. In addition to the drafting of regulations and procedures, and the designing of forms in connection with the International Banking Act and the Financial Institutions Regulatory and Interest Rate Control Act, we would like to see a systematic examination of other pertinent legislation and regulations to determine whether coverage can be improved.

2. Minimize the confidential classification of foreign ownership data so that OFIUS could identify specific ownership insofar as possible in its published reports and listings.

3. Maximize the sharing of confidential foreign ownership data, within statutory limitations, with OFIUS for analytical purposes and the presentation of aggregated data.

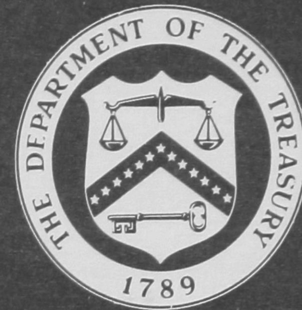
4. Establish retrieval systems in the financial institution regulatory agencies to insure speedy organization of pertinent foreign investor data and delivery to OFIUS.
Financial institution regulatory agencies would also undertake reasonable efforts (cost and personnelwise) to assemble foreign investor data presently diffused in agency headquarters and field records and uncovered by retrieval systems.

If CFIUS could endorse the above objectives (as stated or modified) then I recommend that you ask the Council to place on their agenda a requirement to examine, in the light of the new banking legislation and the above objectives, what measures might be taken to attain the objectives. We would be prepared to work with a Council task force to develop detailed arrangements.



Milton A. Berger
Director
Office of Foreign Investment
in the United States

artment of the TREASURY NEWS
INGTON, D.C. 20220 TELEPHONE 566-2041



FOR IMMEDIATE RELEASE
EXPECTED AT 10:00 a.m. EDT
TUESDAY, JUNE 20, 1978

STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON FAMILY FARMS, RURAL DEVELOPMENT,
AND SPECIAL STUDIES
OF THE
HOUSE COMMITTEE ON AGRICULTURE

Mr. Chairman, I welcome the opportunity to testify before this Subcommittee on the subject of foreign investment in U.S. farmland. The subject is one part of the overall question of foreign investment in the United States. Thus, I would like to lead off by outlining the Administration's basic policy on foreign investment.

Shortly after taking office, this Administration undertook a review of U.S. policy on foreign investment. In July 1977 the Administration issued a statement which confirmed the long-standing U.S. commitment to an open international economic system. Specifically, the statement said: "The fundamental policy of the U.S. Government toward international investment is to neither promote nor discourage inward or outward investment flows or activities." Therefore, the Government "should normally avoid measures which would give special incentives or disincentives to investment flows or activities and should not normally

B-991

intervene in the activities of individual companies regarding international investment. Whenever such measures are under consideration, the burden of proof is on those advocating intervention to demonstrate that it would be beneficial to the national interest."

We are aware, of course, that certain exceptional investments might not be consistent with the national interest. For this reason, regarding inward investment flows, the Administration continued the procedures established in 1975 under Executive Order 11858 for the Committee on Foreign Investment in the United States to "review investments in the United States which in the judgment of the Committee might have major implications for the U.S. national interest." As Assistant Secretary of the Treasury for International Affairs, I chair that Committee under the terms of E.O. 11858.

One important feature of these procedures is a provision for advance consultations with foreign governments on investments in the United States. Under this procedure, foreign governments have been requested to consult with the U.S. Government on any significant direct investments which they might be contemplating making in the United States. If the Committee concluded

that a particular investment would be contrary to the national interest, the foreign government involved would be requested to refrain from making the investment or to modify it in an appropriate manner. While this procedure was established primarily to review major investments by foreign governments, the Committee may also review any major investments here by foreign private parties if those investments appear to have major implications for the national interest.

The members of the Committee are kept informed on investments in the United States by the Office of Foreign Investment in the United States, which was established in the Department of Commerce by the same Executive Order. Mr. Berger, who heads that Office, will testify later on this operation.

As to foreign investment in U.S. farmland, you are well aware that the available data are quite sketchy. Most farmland investments involve smaller order of magnitude than industrial plants, and therefore do not attract the same degree of public notice. A representative from the Department of Agriculture is testifying on that Department's plans to improve our data in this area.

In the meantime, the Administration believes that its policy of not discouraging foreign investment in general applies to foreign investment in U.S. farmland. At a meeting of the Committee on Foreign Investment in the United States held last week it was unanimously agreed that there was no basis at present for a departure from our basic policy in the case of farmland.

Nevertheless, there has quite understandably been a good deal of concern expressed about the sharp rise in the price of farmland. This phenomenon is attributed in part to an increasing demand for U.S. farmland as investments by persons who are not directly involved in farming. The vast majority of absentee farmland owners are Americans; some are foreigners, though the very incomplete data now available suggest that this amount is no more than one percent of total land ownership in this country and much of this ownership is not of recent origin.

Whether purchases by absentee owners have any significant effect on farmland prices is certainly a proper subject for examination. However, we see no basis at this point for differentiating between persons who may be absentee land owners on the basis of their nationality. The economic impact of land purchases does not vary with the geographic residence of the purchaser.

There are two factors which are different for foreigners buying land in the United States as compared to U.S. residents. First, foreigners are subject to different tax laws. Second, foreigners deal in a foreign currency -- the dollar -- when buying and selling U.S. land. Neither of these factors, however, gives foreigners any inherent advantage over Americans in buying land here.

The tax considerations involved are rather complex, and turn on the tax laws of the foreigner's residence as well as U.S. tax laws. I have an addendum to my statement which discusses these considerations. The upshot of this discussion is that whether or not a foreigner is better or worse off from a tax standpoint than an American when buying farmland depends on the particular circumstances of the two individuals.

I want to emphasize, however, that there is no necessary advantage to foreigners merely because profits from sales of U.S. land are not subject to the U.S. capital gains tax. Foreigners subject to the tax laws of Canada, Germany, France, Japan and the United Kingdom, which are reportedly major sources of foreign demand for U.S. farmland, are subject to tax in those countries on capital gains they may derive in the United States and for some at least their tax result may not be too different from an American's. Also in cases where foreigners are not subject to capital gains

tax, neither are they able to deduct capital losses resulting from land sales as U.S. residents can.

In regard to the foreign currency aspect, it is sometimes said that foreigners have an advantage over Americans in that they can buy land with "cheap dollars". But the fact that the mark and the yen will buy more dollars today than in some previous period merely means that Germans and Japanese have more purchasing power in dollars than previously -- whereas Canadian and British citizens, because of the weakening of their currencies, have less. Even residents of countries whose currencies have strenghthened do not have an absolute advantage over Americans. In fact, in a world of floating exchange rates, having to deal in a foreign currency is an additional risk factor for foreigners buying land here, a risk which American land purchasers do not face.

In addition, it should be noted that foreign investment in the United States reduces our balance of payments deficit and strengthens the dollar. Direct investment of a longer term nature is particularly welcome in this respect. It represents a constructive means of financing the sizable current account deficit which we are now running, and

the current account surpluses of foreign countries.

Mr. Chairman, you raised several specific questions about foreign investment in farmland in your letter to Secretary Blumenthal. In response to your questions on the economic impact of this investment, as I have already indicated, I see no reason to believe that it essentially differs from the impact of investment in farmland by Americans except for its effect on our balance of payments.

You also asked whether restrictions on foreign investment would be detrimental to our international interests. They key point is that such restrictions would be detrimental to our _national_ interests. The main reason that this and previous Administrations have followed a neutral policy on foreign investment is that the policy works in the best interests of the U.S. economy. The broader the amount of participation in any market, the greater the competition in and efficiency of the market. To exclude a certain sector of participants in the market purely on the basis of their nationality would have no economic rationale. If we restrict the ability of foreigners to invest in the United States, we also restrict the right of Americans to dispose of their property -- for no apparent purpose -- and we would also run a risk of retaliation against the sizable stock of American investments abroad.

In summary, Mr. Chairman, unless it can be demonstrated that the national interest is adversely affected by foreign investments in U.S. land, there appears to be no basis for treating farmland purchases by foreigners any different than farmland purchases by Americans. The traditional U.S. policy of neutrality toward foreign investment, both inward and outward, should apply here as well.

TAXATION OF INCOME FROM FOREIGN INVESTMENT IN U.S.

Under U.S. tax laws, resident aliens generally are taxed on their income from all sources, both within and outside the United States, in the same manner as U.S. citizens. However, non-resident aliens normally are taxed only on their income from sources within the United States. Special rules apply to the taxing of the income of non-resident aliens, depending on whether such income is derived from passive investments or from the conduct of a business.

In considering how the provisions of the Internal Revenue Code apply to foreign investments in U.S. farmland, it is necessary to consider the legal identity of the investor and the form of the investment. The foreign investor could either be a foreign corporation or an individual. The investment could be in the form of stock in a U.S. corporation, which in turn owns the farmland, or a direct purchase by the foreign investor. In the latter case it may be presumed that the U.S. farm will be operated as a branch of the foreign corporation or, in the case of the foreign individual, as a business with a U.S. manager.

In the case of an indirect investment in farmland through a U.S. corporation, the farm income will first be subject to the U.S. corporate income tax. Distributions out of profits to non-resident aliens will be subject to a 30 percent withholding tax unless reduced through a bilateral income tax convention, which usually provides for a rate of 15 percent. This income will then be subject to the tax laws in the investor's country of residence. It is worth noting that major capital exporting countries such as Canada, Germany, France, 1/ Japan and the U.K. tax the worldwide income of their residents. The tax laws of these, and most other countries, allow residents to take a credit for U.S. withholding tax against their domestic tax liability.

In the case of direct investments, foreign corporations with U.S. source income must file special tax returns (1120 F) with the IRS, and are subject to the same rate schedule as are U.S. corporations. Non-resident alien individuals with income effectively connected with the conduct of a trade or business are required to file a form 1040 NR even if the gross amount of income is less than $750. An investment in a U.S. farm would be considered a trade or a business. This income would be subject to the same

1/ French corporations, however, are in principle not subject to taxation on foreign source income.

tax rate schedules as are applicable to U.S. taxpayers. Again, when the funds are transmitted abroad they will be subject to the tax laws in the investor's country of residence.

Non-resident aliens not present in the United States for at least 183 days during the taxable year are not subject to U.S. tax on gains derived from the sale or exchange of capital assets within the United States. This exemption from taxation applies to all capital assets, however, not just farmland. Whether this constitutes an advantage to foreigners will depend on how they are taxed in their home countries. Canada, Germany, France, Japan and the U.K. tax the worldwide income of their residents including capital gains. To determine whether residents of these countries are subject to lighter or heavier taxes than Americans would require detailed comparisons of the various tax laws. It should also be noted that, in cases where a foreigner is not subject to a capital gains tax, neither is he able to deduct a capital loss from ordinary income as American taxpayers can.

A common problem in determining the tax liability of business enterprises which operate in more than one tax

jurisdiction involves "artificial transfer pricing." Under this practice business enterprises strive to minimize their tax liability by attributing as much of their income as possible to countries with low tax rates. To do this, they tend to sell products produced by their affiliates in high tax countries to their affiliates in low tax countries at artificially low prices rather than the "arm's-length" prices that would be charged to unaffiliated persons.

Tax authorities in all countries have difficulty in preventing these practices because the products involved are frequently unique and the arm's-length or market price is difficult to establish. In the case of foreign-owned U.S. companies engaged in farming, however, the problem is minimal because agricultural products have a wide market and there is little difficulty in establishing an arm's-length price.

In summary, few generalizations can be made as to whether foreigners have a tax advantage or disadvantage vis-a-vis Americans in buying, operating or selling U.S. farmland. The situation will vary in accordance with the individual circumstances of the taxpayers involved.

Attachment to Response to Question #3

Department of the Treasury

1. Report to the Congress, "Foreign Portfolio Investment in the United States", (2 vols.), August 1976 (results of benchmark survey done under Foreign Investment Study Act of 1974).
2. "Taxation of Foreign Investment in U.S. Real Estate", May 1979.
3. "Summary of Federal Laws Bearing on Foreign Investment in the United States", June 1975.
4. Data on foreign portfolio investment in the United States, (published monthly in the Treasury Bulletin).

Department of Commerce - General

5. Report to the Congress, "Foreign Direct Investment in the United States", (9 vol's) April 1976 (result of benchmark survey done under Foreign Investment Study Act of 1974).

Department of Commerce - Office of Foreign Investment in the United States

6. "Foreign Direct Investment in the United States: 1976 Transactions -- All Forms; 1974 - 76 Acquisitions, Mergers and Equity Increases", December 1977.

7. Press release, "Foreign Investment Stays Strong in U.S. in First Half 1977", April 18, 1978.
8. Press release, "ITA Reports Sharp Increase in 1978 Foreign Direct Investment Transactions in United States", June 13, 1979.
9. List of Foreign Direct Investments in the United States - Pending Transactions - 1977.
10. List of Foreign Direct Investments in the United States - Completed Transactions - First Half of 1978.
11. List of Foreign Direct Investments in the United States - Pending Transactions - First Half of 1978.
12. "Foreign Direct Investment in the U.S. Electronic and Printed Media, 1974 - 1978", (Draft copy).
13. "Foreign Investments in the U.S. Graphic Arts", Printing and Publishing, Quarterly Industry Report, Winter 1978/79.
14. "Highlights of Canadian Direct Investment in the United States: 1974 - 1978," (Draft copy).
15. "Foreign Direct Investment in the U.S. Machinery Industry", (Draft copy).

16. "Foreign Direct Investment in the U.S. Chemical Industry", (Draft copy) June 1979.

17. "Foreign Direct Investment in the U.S. Primary and Fabricated Metal Industries, 1974", (Draft copy) June 1979.

18. "Foreign Direct Investment in the U.S. Food Industry", (Draft copy).

19. "Foreign Direct Investment Activity in the United States", Report #79-3, March 1979 (one of a series of monthly reports).

20. "Improvement of Information on Foreign Investment in the U.S. Banking Sector," July 20, 1979, Memorandum from Assistant to Comptroller of Currency, John G. Heimann, transmitting OFIUS suggestion for a work program.

Department of Commerce - Bureau of Economic Analysis

21. "Employment and Employee Compensation of U.S. Affiliates of Foreign Companies, 1974," Survey of Current Business, December 1978.

22. "Foreign Direct Investment in the United States, 1977," Survey of Current Business, August 1978 (annual article).

23. "Gross Product of U.S. Affiliates of Foreign Companies," Survey of Current Business, January 1979.

24. "OPEC Transactions in the U.S. International Accounts, 1972 - 77", Survey of Current Business, April 1978.

25. "The International Investment Position of the United States: Developments in 1977," Survey of Current Business, August 1978 (annual article).

26. "U.S. International Transactions", Survey of Current Business, (quarterly article).

Department of Agriculture

27. "The Agricultural Foreign Investment Disclosure Act of 1978: The First Regulation of Foreign Investment in United States Real Estate," by Bruce Zagaris.

28. "Interim Report: Section 4(d), International Investment Survey Act of 1976", Economics, Statistics, and Cooperatives Service.

29. "Outline of Work: Section 4(d), International Investment Survey Act of 1976", June 1, 1978.

30. "Report of the Agricultural Stabilization and Conservation Service," (on foreign investment in U.S. farmland, by state), September 29, 1978.

markets, we should not close off those markets to willing investors from abroad.

Second, foreign-owned companies have yielded the U.S. economy the same benefits as their domestically-owned counterparts -- that is, employment opportunities, tax revenues, and competitively-priced goods and services. Some foreign investors have brought unique technology to this country, while others have played a major role in the development of particular states or regions, bringing more jobs and other important benefits to their economies.

Our experience has been that the behavior of these companies does not differ from that of domestically-owned firms. The ownership of these companies has not altered their willingness to abide by our laws, and they still must compete in our marketplace.

Third, as this Subcommittee is particularly aware, we are by far the largest foreign investor in the world. The book value of our direct investments overseas -- amounting to well over $100 billion -- is several times greater than foreign direct investment here. Furthermore, we now have treaties of friendship, commerce and navigation with many nations under which they have been promised that their investors -- with certain well-defined exceptions -- will be given equal treatment with American citizens with respect to investments within the United States. A consideration we constantly keep in mind is the necessity that we not endanger these important treaties, which

provide parallel rights to U.S. investors in those countries.

Finally, we must always be aware of the responsibilities attached to the leadership role we play in the world's economy. If we were to abandon our historical support for freedom of movement for capital and adopt investment restrictions, other nations could be expected to follow suit and restrict U.S. investment to a much greater degree than they currently do. The need for worldwide cooperation is great at this time, and we must not risk leading the nations of the world to a retreat into economic isolation.

1975 Policy Review

Despite these considerations, many expressed concerns about the rapid growth in the hands of a few governments of funds available for investment abroad, and we, therefore, recently conducted a complete review of our investment policy and the effectiveness of our relevant laws and regulations. The review was completed in late winter and its results were presented to Congress in several hearings earlier this year.

Our basic conclusion was that the traditional U.S. open policy with respect to foreign investment in this country should be maintained. We have, therefore, opposed proposals for any new restrictions on foreign investment in this country.

Underlying our decision is the belief that our existing laws, regulations, and practices provide extensive information with respect to foreign investments as well as adequate safe-guards to deal with potential problems that might arise in

the case of particular investments. There is a formidable array of such laws, and I am sure that few people in this country really understand the extent of the protection they provide us against abuses by foreign investors.

There are, for example, a number of specific laws which prohibit or limit foreign investment in certain areas of our economy for reasons of national security or to protect an essential national interest. These sectors include atomic energy, domestic airlines, shipping, Federally-owned land, communications and media, and fishing.

Secondly, there are many laws which prevent abuses in specific sectors. Among the most important are those in the defense area. The Defense Department may deny security clearances required to do classified work for the government to any firm under "foreign ownership, control or influence." Foreign investment in defense production facilities, although not expressly prohibited, is severely limited by the prospect that such an acquisition could result in the firm's losing its classified government contracts. Exports of arms and of classified technology related to defense manufacture are also effectively controlled.

Finally, foreign investors are subject to the same laws and regulatory constraints American firms must observe. Many of these are quite familiar, but are not usually thought of as protections against abuse by foreign investors.

-- Our <u>antitrust laws</u> prevent a foreign investor from monopolizing a specific sector, or engaging in various anti-competitive practices. They also prevent foreign investors acting singly or in a group from making a purchase of, or engaging in a merger or joint venture with, a U.S. firm if the result would be to substantially lessen competition or tend to create a monopoly.

-- Our <u>export control authority</u> provides protection against the export of any product or resource if our national security is threatened, if there is an excessive drain of scarce materials and a serious inflationary impact from foreign demand, or if controls are needed to further U.S. foreign policy. Special, more detailed, rules apply to exports of armarments and certain types of energy.

-- Our <u>securities laws</u> require disclosures of significant foreign ownership, prevent harmful activities with respect to tender offers and stock market price manipulation and generally preserve orderly markets.

-- Our <u>labor laws</u> require all firms operating in the United States to refrain from unfair labor practices and to assure all workers safe and healthful working conditions.

-- Finally the President has broad emergency powers, including (1) the Trading with the Enemy Act, which gives him the power during a war or national emergency to control completely any property in the U.S. in which any foreign country or national thereof has any interest; (2) condemnation power

over any property within our jurisdiction; and, (3) priority performance powers which authorize the President to order the priority performance of defense related contracts, to allocate materials and facilities necessary for national defense, and to place priority orders for a particular product and to take possession of the facility if they are not fulfilled.

Despite these extensive safeguards, we did feel that certain new administrative actions to supplement our existing laws and regulations would be desirable. These included:

-- Creation of a new Office on Foreign Investment in the United States, in the Department of Commerce, to synthesize and analyze the data on foreign investment in the United States which is collected by various U.S. Government agencies. Although considerable data on foreign investment has been collected by individual agencies, until the creation of this office there was no central collection or dissemination point for analysis of individual investments.

-- Establishment of a new high-level Committee on Foreign Investment in the United States to monitor the impact of foreign investment in this country and to coordinate the formation of U.S. policy on such investment.

-- Arrangements with the foreign governments for advance consultation with the U.S. Government on their prospective major investments in the United States.

Committee on Foreign Investment in the United States

During the past months, we have made significant progress in implementing these new arrangements. The Committee on Foreign Investment in the United States (the "Committee") was established on May 7, 1975 pursuant to Executive Order 11858. Under this Executive Order, the Committee has "primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of the United States policy on such investment."

The membership of the Committee consists of representatives of Government departments and agencies which are generally concerned with foreign investment issues, including among others State, Commerce, Defense, and Treasury, whose representative serves as Chairman. Thus, the Treasury Department has responsibility for coordinating the activities of the Committee. The Committee also invites representatives of other agencies which have an interest in a particular issue under review to participate in its discussions of that issue.

Also as implementation of the Executive Order, the Commerce Department has established an Office of Foreign Investment in the United States to support the Committee's activity. The Office's responsibilities include developing a consistent and timely data collection and processing system on foreign investment activity in the United States; providing evaluations and reports concerning the impact of foreign investment to the Committee; and preparing reports for publication.

The Office has been preparing statistical and other analyses for the use of the Committee and is working intensively with a mangement consulting team and other government agencies to develop improvements in the existing system to secure more complete and timely data.

Committee Review of Specific Investments

In addition to its overall policy responsibilities, the Committee is required to "review investments in the United States which, in the judgment of the Committee, might have major implications for the United States national interest." With respect to specific investment transactions, the Committee is primarily concerned with direct investment in the U.S. by foreign governments -- although the Committee may review those extraordinary private investments which may clearly adversely affect the national interest.

As part of our policy, we have asked all foreign governments contemplating significant foreign investment in this country to hold prior consultations with the United States. The Committee is to assist in these consultations.

We already have had clear indications that other countries recognize our legitimate interests with respect to investments in the U.S. by foreign governments. In fact, I have personally discussed this policy with the major potential government investors in the Middle East and found a broad acceptance of our desire for consultations as long as they are applied to all governments on a non-discriminatory basis; and, of course, they will be equitably applied. The experience we had with Iran in connection with its proposed investment in Pan Am and with Romania in connection with its proposed joint venture with Island Creek Coal Co. are good examples of how

such procedures can work to the satisfaction of both governments.

I think the easiest way for me to explain how the Committee might review a major foreign government investment proposal would be to explain on a step-by-step basis the procedures we would follow on handling cases that come before us. Most commonly, Committee involvement in a particular case would be touched off by the receipt from a foreign government of notification of its intent to make an investment.

When we receive notification from a foreign government, the information supplied is analyzed initially by the staff of the Secretary of the Committee on Foreign Investment in the U.S. in the Treasury Department. The action taken will be determined in accordance with the facts in the case. The Committee could, for example, simply indicate that it had "no objection" to the investment. Alternatively, the Committee may decide to request consultations and to initiate a more extensive review procedure. This could range from asking the investor for one additional piece of information to undertaking lengthy consultations.

It is anticipated that only a few investments that come before the Committee will reach the stage in which extensive consultations would be required.

The Committee would handle <u>private investments</u> somewhat differently. The key difference is that we have not

specifically requested that private investors enter into prior consultations on proposed investments. We would regard such a requirement as both unnecessary and inappropriate. In the event that a private investment which came to our attention could clearly have adverse implications for our national interest, the Committee would ask the parties involved to consult with it.

Potential Acquisition of Copperweld Corporation

We initially became aware of the proposed takeover of Copperweld Corporation by Societe Imetal through public reports of the French firm's tender offer. As the issues involved in the case became clearer, the new office at the Commerce Department kept abreast of the situation by establishing contacts within the other U.S. Government agencies involved in the case.

I was in touch with the French Ambassador and other officials here in Washington in order to clarify our policy with respect to foreign investment in the United States and to ascertain to what degree the French Government was involved in this investment. They advised me that there is no French Government involvement in the management of Societe Imetal.

The Committee became officially involved when it received a letter, dated September 10, 1975, from Mr. Phillip H. Smith, Chairman and President of Copperweld Corporation, concerning the proposed acquisition of his firm. Some days earlier, Under Secretary Yeo, the Chairman of the Committee, had notified its members that he had disqualified himself from participating in any consideration of any U.S. Government action concerning the proposed transaction because of his prior professional relationship and friendship with Mr. Smith. Consequently, on receipt of his letter, I assumed the post of Acting Chairman and determined that the Committee should review the issues Mr. Smith had raised. A meeting of the Committee was called for September 18th. In preparation for the meeting, the new Office of Foreign Investment in the United States, in the Commerce Department, investigated the background of the case, drawing upon resources within the Commerce Department and its contacts with officials of the Securities and Exchange Commission and the Justice Department. My staff and that of the office were also in contact with the Department of Defense, which was analyzing the possible defense implications of the transaction.

After full consideration of the facts, the Committee concluded that it had no basis for interposing itself in this transaction. This conclusion has been communicated to Mr. Smith.

Conclusion

The lessons we have drawn from our analysis of our experience with this case provide the answers to many of the questions you raised, Mr. Chairman, in your invitation to me to testify today.

First, the conclusion of our policy review that we should not require prior notification with respect to private investments continues to be sound. Both the new office at Commerce and our staff at the Treasury Department were closely following the developments with respect to Copperweld at an early stage, and we were able to act expeditiously on it once it was formally brought before us.

Second, none of the developments in this case indicate to us a need for additional legislation to safeguard the national interests in regard to foreign investments in this country. We continue to feel that our current safeguards against abuses of investment in this country, by domestic and foreign persons, are adequate and we see no reasons to depart from our traditional open policy.

During the past decade, foreign investors have become increasingly attracted to invest in the United States for a number of reasons: we offer a vast, affluent, and integrated market; we are rich in natural and human resources needed to service such investment; and there are intangible benefits, such as access to advanced technology, which result from participation in the U.S. market. However, the single most important factor has been that our markets have remained open and we have afforded domestic and foreign investors equal treatment. I believe it is essential that we protect our national interests, but this can be done without altering this basic underlying policy.

I hope that these remarks will be useful to your Committee, Mr. Chairman, and I will be happy to answer any further questions you may have.

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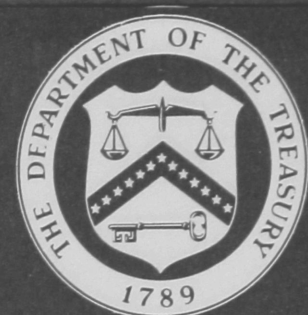

FOR IMMEDIATE RELEASE July 30, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,001 million of 13-week bills and for $3,000 million of 26-week bills, both to be issued on August 2, 1979, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing November 1, 1979			26-week bills maturing January 31, 1980		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.691	9.135%	9.51%	95.302	9.293%	9.91%
Low	97.679	9.182%	9.56%	95.294	9.309%	9.93%
Average	97.686	9.154%	9.53%	95.298	9.301%	9.92%

Tenders at the low price for the 13-week bills were allotted 90%.
Tenders at the low price for the 26-week bills were allotted 89%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 60,650	$ 34,550	$ 51,585	$ 26,400
New York	4,657,710	2,538,110	4,941,865	2,704,730
Philadelphia	41,540	40,615	14,860	14,860
Cleveland	45,680	35,325	17,285	17,235
Richmond	29,860	24,860	36,275	20,275
Atlanta	41,195	38,465	23,395	23,370
Chicago	236,690	59,060	299,525	56,675
St. Louis	36,675	17,375	31,005	10,005
Minneapolis	12,295	4,295	12,585	8,145
Kansas City	30,995	30,985	25,685	22,110
Dallas	19,405	19,405	11,275	11,265
San Francisco	299,525	134,525	296,410	56,410
Treasury	23,175	23,165	28,670	28,670
TOTALS	$5,535,395	$3,000,735	$5,790,420	$3,000,150
Type				
Competitive	$3,875,770	$1,341,110	$3,945,300	$1,155,030
Noncompetitive	488,855	488,855	348,120	348,120
Subtotal, Public	$4,364,625	$1,829,965	$4,293,420	$1,503,150
Federal Reserve and Foreign Official Institutions	1,170,770	1,170,770	$1,497,000	$1,497,000
TOTALS	$5,535,395	$3,000,735	$5,790,420	$3,000,150

1/Equivalent coupon-issue yield.

B-1762

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NEWS
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FOR RELEASE UPON DELIVERY
EXPECTED AT 10 A.M.
July 31, 1979

STATEMENT BY
GARY C. HUFBAUER
DEPUTY ASSISTANT SECRETARY FOR
INTERNATIONAL TRADE AND INVESTMENT POLICY
DEPARTMENT OF THE TREASURY

Mr. Chairman, my remarks this morning on the omnibus maritime bill are directed at Title III, the title concerning promotional policies. I will be presenting the Treasury's initial views and not the Administration's definitive position since the Administration has not yet reviewed the detailed proposals in your bill.

The President's letter of July 20 and your bill, Mr. Chairman, reveal one major point of difference concerning promotional policy: U.S. policy toward bilateral agreements. Section 301 of the Omnibus Bill directs the Secretary of Commerce to "negotiate appropriate commercial agreements with foreign nations to assure that, within five years of enactment of this section ... United States vessels carry a fair share of the foreign commerce of the United States."

B-1763

The President, by contrast, calls the current trend toward bilateral cargo sharing agreements "neither wise nor necessary" and states that "we will continue to resist the imposition of cargo sharing regimes." Treasury believes that dividing up the world's trade routes by governmental agreement will lessen innovation and remove incentives for carriers to provide efficient service that meets shippers' needs. The promotion of our foreign commerce -- the first declared purpose of this legislation in Section 102 -- is better served by competition among carriers.

The Administration recognizes that cargo sharing agreements must at times be adopted in response to initiatives by foreign governments. The President made clear that, in those instances, we will defend the interests of our carriers and adopt cargo sharing agreements. But we will not seek to enter into such agreements unless first provoked by foreign measures.

In another area -- reform of the dry bulk subsidy program -- the Administration's proposal tracks very closely with the Omnibus Bill. The current dry bulk subsidy program has not substantially improved the position of U.S. carriers. The President, and this legislation, propose the elimination of a number of restrictions on those bulk operators under the subsidy program. These initiatives are intended to revitalize that subsidy program and encourage its use by U.S. operators. The President's proposals would eliminate existing restrictions on:

-- Foreign resales;

-- International trading rights;

-- Repair in foreign shipyards; and

-- Ownership of both foreign and U.S. vessels.

I believe that the spirit both of your legislation and of the Administration proposal is identical: allow bulk carriers to make more efficient use of subsidy dollars.

Your bill, Mr. Chairman, goes considerably further than the President's proposals by allowing greater flexibility for all Operating Differential Subsidy (ODS)-supported operators -- including liners -- and Construction Differential Subsidy (CDS)-supported construction. Treasury thinks that serious consideration should be given to your proposals and their impact on the industry. We recognize that different circumstances apply to bulk trades than the liner trades and ship construction, and that the Administration will have to analyze the bill's provisions in greater detail. Nonetheless, the Federal Government should consider cutting needless restrictions attached to subsidies whenever they hamper the subsidy program's goal of promoting our merchant marine and the shipbuilding base.

For instance, the following initiatives could obviously have a large impact on the maritime industry and should be carefully reviewed:

-- Elimination of ODS ties to "essential trade routes;"

-- Elimination of the ban on foreign-to-foreign trading for all ODS vessels;

-- Liberalization of the restrictions on shifting of ODS vessels between foreign and domestic trades;

-- Liberalization of current restrictions on use of foreign components in the construction of vessels in U.S. shipyards; and

-- Provision for temporary suspension of ODS contracts by carriers.

Finally, Mr. Chairman, your bill proposes certain changes in the operation of Capital Construction Funds (CCF). I will not discuss those proposals today because they involve changes in our tax laws. Thus, we believe they are appropriately considered with Title IV of the bill, Amendments to the Internal Revenue Code. Treasury will be prepared to address the CCF and other tax provisions when the Committee takes up Title IV.

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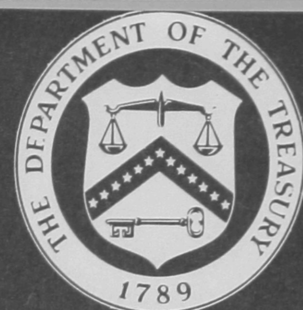


FOR IMMEDIATE RELEASE

July 31, 1979

RESULTS OF AUCTION OF 3-YEAR NOTES

The Department of the Treasury has accepted $2,753 million of $6,725 million of tenders received from the public for the 3-year notes, Series M-1982, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	9.03%
Highest yield	9.07%
Average yield	9.06%

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

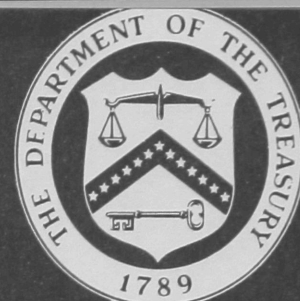
Low-yield price	99.923
High-yield price	99.820
Average-yield price	99.845

The $2,753 million of accepted tenders includes $611 million of noncompetitive tenders and $1,562 million of competitive tenders from private investors, including 69% of the amount of notes bid for at the high yield. It also includes $580 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 $2,753 million of tenders accepted in the auction process, $775 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 August 15, 1979.

B-1764

partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041



July 31, 1979

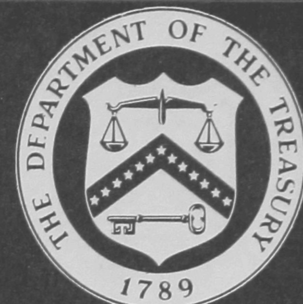
Statement by Treasury Department
Regarding Chrysler Corporation

The Treasury Department has monitored Chrysler's financial situation in the past several months, and is concerned about its possible impact on the overall economy and on the employees of Chrysler and its suppliers. The Treasury, in cooperation with staff from the Federal Reserve System, is making a comprehensive study of the company's financial records and operations. When Treasury's final analysis is completed, the results will be considered by others in the Administration which will then be in a position expeditiously to address Chrysler's proposals for assistance.

Other federal agencies involved in analyzing the Chrysler Corporation financial situation are the Department of Commerce, Environmental Protection Agency, Department of Transportation, Council on Environmental Quality, Department of Justice, Federal Trade Commission, Office of Management and Budget, and the Council of Economic Advisers. The Treasury report, based on its own investigation and those of the other involved federal agencies, is now being expedited.

B-1765

partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041



FOR IMMEDIATE RELEASE
July 31, 1979

CONTACT: Charles Arnold
202/566-2041

Gerald Murphy Named Deputy Fiscal Assistant Secretary

Secretary of the Treasury W. Michael Blumenthal today appointed Gerald Murphy to the position of Deputy Fiscal Assistant Secretary of the Treasury.

Mr. Murphy is a career official who entered the Federal Service with the Department of the Navy in January 1957. He joined the Department of the Treasury in October 1959 and has served in a variety of staff and managerial positions. Since 1975, he has been Deputy Commissioner of the Bureau of Government Financial Operations.

He received a bachelor's degree and masters degree in Commercial Science from Benjamin Franklin University in 1960, and 1963, respectively. He also attended American University and has served on the faculties at Southeastern University and the U.S. Department of Agriculture Graduate School.

Mr. Murphy is a member of the American Institute of Certified Public Accountants. He currently serves on the National Council on Governmental Accounting and is a past National President of the Association of Government Accountants. He has received Treasury's Meritorious Service Award, the Secretary's Special Act or Service Award and the Benjamin Franklin University Distinguished Alumni Award.

He is married to the former Harriet Gottlick of Westfield, New Jersey, and they have three children, William, Janet and Kathleen. Mr. Murphy and his family reside in Silver Spring, Maryland.

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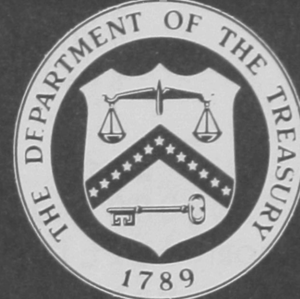
B-1766

partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041



FOR RELEASE AT 4:00 P.M. July 31, 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 August 9, 1979. This offering will not provide new cash for the Treasury as the maturing bills are outstanding in the amount of $6,021 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 May 10, 1979, and to mature November 8, 1979 (CUSIP No. 912793 2U 9), originally issued in the amount of $3,016 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated August 9, 1979, and to mature February 7, 1980 (CUSIP No. 912793 3Q 7).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing August 9, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $3,295 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, August 6, 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-1767

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. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. 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. 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, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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 on August 9, 1979, in cash or other immediately available funds or in Treasury bills maturing August 9, 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.

partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
July 31, 1979

Contact: John P. Plum
202/566-2615

INTEREST RATE INCREASED FOR RETIREMENT PLAN BONDS AND INDIVIDUAL RETIREMENT BONDS

The Treasury Department today announced an interest rate increase of one-half percent for new issues of U.S. Retirement Plan Bonds and U.S. Individual Retirement Bonds. Bonds of both series issued on and after August 1, 1979, will provide an investment yield of 6-1/2 percent, compounded semiannually. This will make the rate on new issues comparable with that of U.S. Savings Bonds.

Since there is no legal authority to change the rate on outstanding Retirement Plan and Individual Retirement Bonds, bonds issued prior to August 1, 1979, will not be affected by the rate increase.

Retirement Plan Bonds, issued pursuant to the Self-Employed Individuals Tax Retirement Act of 1962, are available for investment by self-employed persons and qualified pension and profit-sharing trusts. Individual Retirement Bonds, issued pursuant to the Employee Retirement Income Security Act of 1974, are available for investment by persons eligible to establish an individual retirement account (IRA) for tax-sheltered retirement savings.

Information and purchase applications for these bonds may be obtained from any Federal Reserve Bank or Branch or Bureau of the Public Debt, Washington, D.C. 20226.

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B-1768

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press inquiries: 202-566-2615

FOR IMMEDIATE RELEASE August 1, 1979

FEDERAL FINANCING BANK ACTIVITY

Roland H. Cook, Secretary, Federal Financing Bank (FFB), announced the following activity for June 1 - 30, 1979.

Guarantee Programs

FFB entered into two new foreign military sales loan commitments in June: $175 million with Turkey and $.2 million with Haiti. Both loans are guaranteed by the Department of Defense under the Arms Export Control Act.

FFB also made 40 advances totalling $274,509,924.97 to 17 foreign governments under existing DOD-guaranteed foreign military sales loans.

Under notes guaranteed by the Rural Electrification Administration, FFB advanced a total of $243,997,000 to 25 rural electric and telephone systems.

On June 20, FFB purchased a total of $4,905,000 in debentures issued by 8 small business investment companies. These debentures are guaranteed by the Small Business Administration and mature in 5, 7 and 10 years. The 5 and 7 year debentures carry an interest rate of 9.035%, while the 10 year debentures carry a rate of 9.125%.

FFB provided Western Union Space Communications, Inc., with the following amounts which mature October 1, 1989. Interest is payable on an annual basis.

Date	Amount	Interest Rate
6/1	$ 2,500,000	9.464%
6/20	16,950,000	9.31%
6/29	1,900,000	9.144%

This loan will be repaid with payments to be made by NASA under a satellite procurement contract with Western Union Space Communications, Inc.

B-1769

FFB purchased two General Services Administration interim public buildings purchase certificates:

Series	Date	Amount	Maturity	Interest Rate
M-046	6/11	$5,975,757.23	7/31/03	9.056%
L-055	6/14	974,035.38	11/15/04	9.009%

FFB advanced the City of Kansas City, Missouri $900,000 on June 29 under the Department of Housing and Urban Development Section 108 Block Grant Program. This advance is scheduled to be repaid June 15, 1980 and carries an interest rate of 9.515%.

Department of Transportation (DOT) Guarantees

The United States Railway Association (USRA) issued a new note #15 to the FFB on June 26. This note is for $2,414,511, matures December 26, 1990, and carries an interest rate of 9.155%. The proceeds were used to repay the FFB interest on earlier USRA notes which funded USRA loans to the Delaware & Hudson Railway Company.

FFB provided the following amounts to the National Railroad Passenger Corp. (Amtrak).

Date	Note #	Amount	Maturity	Interest Rate
6/1	18	$ 3,500,000	6/29/79	10.082%
6/5	18	6,000,000	6/29/79	10.078%
6/7	18	500,000	6/29/79	9.84%
6/7	20	5,500,000	9/6/79	9.84%
6/11	18	6,000,000	6/29/79	9.648%
6/11	20	1,000,000	9/6/79	9.648%
6/12	20	4,000,000	9/6/79	9.442%
6/15	20	16,000,000	9/6/79	9.358%
6/19	20	8,000,000	9/6/79	9.349%
6/22	20	3,000,000	9/6/79	9.442%
6/27	20	3,000,000	9/6/79	9.201%

On June 29, Amtrak extended the maturity on the $100 million Note #18 for 91 days to September 28, 1979. This extended note carries a new interest rate of 9.358%.

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
Trustee of The Milwaukee Road	6/8	$ 408,420.00	11/15/91	9.27%
Chicago & North Western 511-78-3	6/18	1,151,555.00	11/1/90	9.101%
Trustee of Chicago, Rock Island	6/18	2,108,567.00	12/10/93	9.345%

Agency Issuers

On June 1, the Export-Import Bank sold FFB a $1,283 million note which matures September 1, 1982. Interest is charged on the note at 9.491%, payable quarterly. This note raised $715 million in new cash and refinanced $568 million in maturing securities.

FFB advanced $45 million to the Student Loan Marketing Association (SLMA), a federally chartered private corporation. FFB holdings of SLMA notes now total $1,140 million.

On June 4, FFB purchased a $1,150 million Certificate of Beneficial Ownership from the Farmers Home Administration. This certificate matures June 4, 1984 and carries an interest rate of 9.39%, payable annually.

The Tennessee Valley Authority sold FFB a $55 million, 9.457% note on June 15, and a $1,095 million, 9.296% note on June 29. Both notes mature September 28, 1979. Of the total $1,150 million borrowed, $970 million retired maturing securities, and $180 million raised new cash.

FFB Holdings

As of June 30, 1979, FFB holdings totalled $60.8 billion. FFB Holdings and Activity Tables are attached.

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FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)

Program	June 30, 1979	May 31, 1979	Net Change (6/1/79-6/30/79)	Net Change-FY 1979 (10/1/78-6/30/79)
On-Budget Agency Debt				
Tennessee Valley Authority	$ 6,610.0	$ 6,430.0	$ 180.0	$ 1,390.0
Export-Import Bank	7,846.3	7,131.3	715.0	1,278.0
Off-Budget Agency Debt				
U.S. Postal Service	1,952.0	1,952.0	-0-	-162.0
U.S. Railway Association	430.3	427.9	2.4	73.5
Agency Assets				
Farmers Home Administration	29,200.0	28,050.0	1,150.0	6,925.0
DHEW-Health Maintenance Org. Loans	77.3	72.6	4.7	20.3
DHEW-Medical Facility Loans	160.1	163.7	-3.6	-3.6
Overseas Private Investment Corp.	38.0	38.0	-2.2	-4.3
Rural Electrification Admin.-CBO	921.0	921.0	-0-	283.3
Small Business Administration	98.7	100.2	-1.5	-13.5
Government Guaranteed Loans				
DOT-Emergency Rail Services Act	22.4	22.4	-0-	4.9
DOT-Title V, RRRR Act	80.5	76.9	3.7	44.8
DOD-Foreign Military Sales	4,990.3	4,791.4	198.9	1,012.4
General Services Administration	340.4	333.5	6.9	70.2
Guam Power Authority	36.0	36.0	-0-	-0-
DHUD-New Communities Admin.	38.5	38.5	-0-	-0-
DHUD-Community Block Grant	1.9	1.0	0.9	1.9
Nat'l. Railroad Passenger Corp. (AMTRAK)	450.8	394.3	56.5	-83.6
NASA	382.5	361.2	21.4	146.0
Rural Electrification Administration	5,497.0	5,253.0	244.0	1,305.4
Small Business Investment Companies	303.0	298.1	4.9	52.4
Student Loan Marketing Association	1,140.0	1,095.0	45.0	395.0
Virgin Islands	21.6	21.6	-0-	-0.2
WMATA	177.0	177.0	-0-	-0-
TOTALS	$60,815.5*	$58,186.4*	$2,627.1*	$13,736.0*

Federal Financing Bank

July 25, 1979

*totals do not add due to rounding.

FEDERAL FINANCING BANK

June 1979 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
Department of Defense					
Thailand #2	6/1	$ 539,371.41	6/30/83	9.485%	
Thailand #3	6/1	100,657.00	9/20/84	9.383%	
Tunisia #4	6/4	531,739.58	10/1/85	9.332%	
Costa Rica #1	6/5	3,880.44	4/10/83	9.505%	
Colombia #2	6/5	860,317.17	9/20/84	9.362%	
Greece #10	6/5	2,567,977.00	2/1/89	9.245%	
Morocco #5	6/5	23,373,100.00	4/10/87	9.276%	
Thailand #6	6/6	3,300,000.00	9/20/85	9.274%	
Taiwan #8	6/7	2,721,452.35	7/1/85	9.222%	
Taiwan #9	6/7	10,000,000.00	7/1/86	9.198%	
Korea #9	6/7	100,000.00	6/30/87	9.165%	
Israel #7	6/12	59,037,747.58	12/15/08	9.109%	
Tunisia #4	6/13	709,845.60	10/1/85	8.975%	
Jordan #2	6/13	987,354.90	11/26/85	8.972%	
Jordan #3	6/13	1,798,179.00	12/31/86	8.961%	
Colombia #2	6/13	415,364.44	9/20/84	9.002%	
Korea #10	6/15	70,996,615.12	12/31/87	9.001%	
Greece #10	6/15	370,000.00	2/1/89	9.014%	
Turkey #2	6/15	6,336,186.54	10/1/86	9.034%	
Turkey #4	6/15	7,328,798.05	10/1/87	9.027%	
Turkey #6	6/15	6,323,930.34	6/3/88	9.021%	
Thailand #2	6/15	1,618,707.00	6/30/83	9.149%	
Thailand #3	6/15	1,761,000.00	9/20/84	9.078%	
Jordan #3	6/18	97,440.00	12/31/86	9.148%	
Colombia #2	6/20	1,188,737.20	9/20/84	9.183%	
Ecuador #2	6/20	23,500.00	8/25/84	9.184%	
Spain #2	6/20	3,802,963.58	9/15/88	9.100%	
Tunisia #4	6/20	54,231.00	10/1/85	9.145%	
Jordan #3	6/22	327,275.00	12/31/86	9.123%	
Costa Rica #1	6/22	141,244.00	4/10/83	9.288%	
Turkey #7	6/22	1,210,725.00	6/3/91	9.089%	
Liberia #4	6/22	25,000.00	10/31/84	9.177%	
Israel #7	6/26	35,611,016.28	12/15/08	9.091%	
Peru #4	6/26	94,920.00	4/10/85	9.151%	
Greece #10	6/26	8,694,001.57	2/1/89	9.103%	
Indonesia #4	6/26	7,558,920.00	9/20/87	9.111%	
Jordan #3	6/29	3,025.09	12/31/86	8.924%	
Jordan #4	6/29	354,746.73	3/15/88	8.941%	
Kenya #6	6/29	3,140,473.00	10/1/88	8.935%	
Spain #2	6/29	8,695,786.00	9/15/88	8.935%	
Thailand #6	6/29	1,695,079.00	9/20/85	8.956%	
Tunisia #4	6/29	8,618.00	10/1/85	8.955%	
Export-Import Bank					
	6/1	1,283,000,000.00	9/1/82	9.604%	9.491% quarterly
Farmers Home Administration					
Certificate of Beneficial Ownership	6/4	1,150,000,000.00	6/4/84	9.185%	9.396% annually
General Services Administration					
Series M-046	6/11	5,975,757.23	7/31/03	9.056%	
Series L-055	6/14	974,035.38	11/15/04	9.009%	
Department of Housing and Urban Development					
Section 108					
Kansas City, Missouri	6/29	900,000.00	6/15/80	9.515%	

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)	
National Railroad Passenger Corp. (AMTRAK)						
Note #18	6/1	$ 3,500,000.00	6/29/79	10.082%		
Note #18	6/5	6,000,000.00	6/29/79	10.078%		
Note #18	6/7	500,000.00	6/29/79	9.84%		
Note #20	6/7	5,500,000.00	9/6/79	9.84%		
Note #18	6/11	6,000,000.00	6/29/79	9.648%		
Note #20	6/11	1,000,000.00	9/6/79	9.648%		
Note #20	6/12	4,000,000.00	9/6/79	9.442%		
Note #20	6/15	16,000,000.00	9/6/79	9.358%		
Note #20	6/19	8,000,000.00	9/6/79	9.349%		
Note #20	6/22	3,000,000.00	9/6/79	9.422%		
Note #20	6/27	3,000,000.00	9/6/79	9.201%		
Rural Electrification Administration						
Allegheny Electric #93	6/1	1,135,000.00	6/30/81	9.695%	9.58%	quarterly
Medina Electric #113	6/1	1,438,000.00	6/1/81	9.735%	9.619%	"
Arkansas Electric #97	6/1	4,649,000.00	12/31/13	9.256%	9.151%	"
Dairyland Power #54	6/4	3,375,000.00	12/31/13	9.244%	9.140%	"
Glacier State Tele. #29	6/6	908,000.00	6/6/81	9.675%	9.561%	"
Basin Electric #137	6/6	49,524,000.00	6/6/81	9.675%	9.561%	"
Chugach Electric #82	6/7	1,169,000.00	12/31/13	9.178%	9.075%	"
Sugar Land Telephone #69	6/8	597,000.00	12/31/13	9.07%	8.969%	"
Tri-State Gen. & Trans. #79	6/8	1,109,000.00	5/31/86	9.045%	8.945%	"
Wabash Valley Power #104	6/8	3,289,000.00	12/31/13	9.07%	8.969%	"
Pacific Northwest Gen. #118	6/8	2,033,000.00	12/31/13	9.07%	8.969%	"
Wolverine Electric #100	6/11	2,570,000.00	6/11/81	9.425%	9.317%	"
Northern Michigan Elect. #101	6/11	3,283,000.00	6/11/82	9.105%	9.004%	"
Colorado-Ute Electric #78	6/11	2,762,000.00	6/11/81	9.425%	9.317%	"
Minnkota Power #127	6/11	7,751,000.00	6/11/81	9.425%	9.317%	"
Allegheny Electric #93	6/11	1,478,000.00	6/30/81	9.405%	9.297%	"
Tri-State Gen. & Trans. #89	6/12	3,259,000.00	3/31/86	9.075%	8.974%	"
Western Illinois Power #99	6/13	1,316,000.00	6/13/81	9.225%	9.121%	"
Basin Electric #86	6/18	1,000,000.00	6/18/81	9.415%	9.307%	"
Tri-State Gen. & Trans. #37	6/18	300,000.00	5/31/86	9.085%	8.984%	"
Associated Electric #132	6/19	10,500,000.00	6/19/81	9.435%	9.326%	"
Big Rivers Electric #58	6/20	2,258,000.00	6/20/81	9.415%	9.307%	"
Big Rivers Electric #91	6/20	3,536,000.00	6/20/81	9.415%	9.307%	"
Big Rivers Electric #136	6/20	359,000.00	6/20/81	9.415%	9.307%	"
Doniphan Telephone #14	6/20	150,000.00	12/31/13	9.112%	9.011%	"
Cooperative Power #130	6/21	8,000,000.00	6/21/81	9.425%	9.317%	"
Arizona Electric #60	6/21	9,700,000.00	12/31/13	9.100%	8.999%	"
East Kentucky Power #73	6/22	6,930,000.00	6/22/81	9.425%	9.317%	"
So. Mississippi Electric #3	6/26	1,462,000.00	6/28/81	9.375%	9.268%	"
So. Mississippi Electric #90	6/26	788,000.00	6/28/81	9.375%	9.268%	"
Corn Belt Power #94	6/27	293,000.00	7/15/81	9.135%	9.033%	"
Big Rivers Electric #65	6/29	56,000.00	6/29/81	9.125%	9.023%	"
Big Rivers Electric #91	6/29	522,000.00	6/29/81	9.125%	9.023%	"
United Power #67	6/29	17,300,000.00	6/29/81	9.125%	9.023%	"
Wolverine Electric #100	6/29	1,560,000.00	6/29/81	9.125%	9.023%	"
Soyland Power #105	6/29	6,315,000.00	6/29/81	9.125%	9.023%	"
Basin Electric #137	6/29	54,867,000.00	6/29/81	9.125%	9.023%	"
Oglethorpe Electric #74	6/29	17,468,000.00	7/15/81	9.115%	9.013%	"
Tri-State Gen. & Trans. #89	6/29	6,255,000.00	5/31/86	8.905%	8.808%	"
North West Telephone #62	6/29	1,207,000.00	12/31/13	9.004%	8.905%	"
Wabash Valley Power #104	6/29	1,526,000.00	12/31/13	9.004%	8.905%	"
Small Business Investment Companies						
Capital for Terrebonne, Inc.	6/20	500,000.00	6/1/84	9.035%		
Capital Resource Co. of Conn.	6/20	555,000.00	6/1/84	9.035%		
Intergroup Venture Capital Corp.	6/20	300,000.00	6/1/84	9.035%		
Intergroup Venture Capital Corp.	6/20	200,000.00	6/1/86	9.035%		
Brantman Capital Corp.	6/20	350,000.00	6/1/89	9.125%		
Builders Capital Corp.	6/20	1,000,000.00	6/1/89	9.125%		
The Christopher SBIC	6/20	500,000.00	6/1/89	9.125%		
J.H. Foster & Co.	6/20	1,000,000.00	6/1/89	9.125%		
SBIC of America	6/20	500,000.00	6/1/89	9.125%		

FEDERAL FINANCING BANK

June 1979 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
Student Loan Marketing Association					
Note #199	6/5	$ 380,000,000.00	6/12/79	10.078%	
Note #200	6/12	505,000,000.00	6/19/79	9.442%	
Note #201	6/19	600,000,000.00	6/26/79	9.349%	
Note #202	6/26	700,000,000.00	7/3/79	9.278%	
Tennessee Valley Authority					
Note #100	6/15	55,000,000.00	9/28/79	9.457%	
Note #101	6/29	1,095,000,000.00	9/28/79	9.296%	
Department of Transportation Section 511					
Trustee of The Milwaukee Road	6/8	408,420.00	11/15/91	9.066%	9.271% annually
Chicago & North Western 511-78-3	6/18	1,151,555.00	11/1/90	9.101%	
Trustee of Chicago, Rock Island	6/18	2,108,567.00	12/10/93	9.136%	9.345% annually
United States Railway Association					
Note #15	6/26	2,414,511.00	12/26/90	9.155%	
Western Union Space Communications, Inc. (NASA)					
	6/1	2,500,000.00	10/1/89	9.25%	9.464% annually
	6/20	16,950,000.00	10/1/89	9.103%	9.31% "
	6/29	1,900,000.00	10/1/89	8.944%	9.144% "

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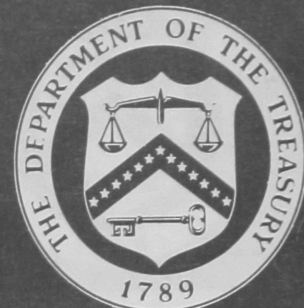

FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE GERALD L. PARSKY
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE,
INVESTMENT AND MONETARY POLICY
OF THE
HOUSE COMMITTEE ON BANKING AND CURRENCY
WEDNESDAY, SEPTEMBER 24, 1975, AT 10:00 A.M.

Mr. Chairman and Members of the Subcommittee:

I am pleased to respond to the Chairman's request to discuss United States policy with respect to foreign investment and the Treasury Department's role in foreign investments in the United States. You have also asked me to discuss the proposed acquisition of Copperweld Corporation by the French enterprise, Societe Imetal.

Although it is inappropriate for me to discuss the merits of the proposed investment, in part because it is currently the subject of litigation in the courts, I am fully prepared to discuss, in accordance with the Chairman's request, how our investment policy in general relates to this case and the role that the Committee on Foreign Investment in the United States has played in connection with it.

WS-383

Traditional U.S. Policy

I think it would be useful to review briefly for you our traditional policy with respect to foreign investment here, so that you will have a fuller appreciation of the context within which the Administration has acted in this sphere.

U.S. policy with respect to international investment has generally been based on the premise that we should rely on the private market as the most efficient means to determine the allocation and use of capital in the international economy.

Accordingly, our basic policy toward foreign investment in the United States has reflected an "open door" approach. That is, we offer foreigners no special incentives to invest here and, with a few internationally recognized exceptions, have imposed no special barriers. Furthermore, foreign investors are generally treated equally with domestic investors once they are established here.

There are a number of important reasons for our maintaining an open policy toward foreign investment. First, foreign investment helps us to meet our large and rapidly growing capital needs. At a time when firms are facing difficult financing requirements, we believe it would not be wise to raise new restrictions on the available sources of capital. Our open policy towards capital flows is conducive to a healthy growing U.S. economy and in this respect is beneficial to domestic capital formation. Moreover, at a time when unprecedented budget deficits will place extraordinary demands on our capital

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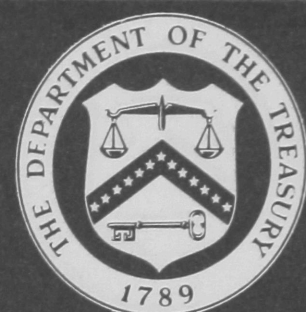

FOR IMMEDIATE RELEASE August 1, 1979

RESULTS OF AUCTION OF 9% 7-1/2-YEAR TREASURY NOTES

The Treasury has accepted $2,504 million of the $5,367 million of tenders received from the public for the 9% 7-1/2 year notes, Series B-1987, auctioned today. The range of accepted competitive bids was as follows:

	Price	Approximate Yield
High	100.07	8.99%
Low	99.96	9.01%
Average	100.00	9.00%

The $2,504 million of accepted tenders includes $411 million of noncompetitive tenders and $1,793 million of competitive tenders from private investors, including 68% of the amount of notes bid for at the low price. It also includes $300 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 $2,504 million of tenders accepted in the auction process, $500 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 August 15, 1979.

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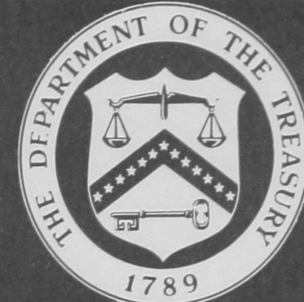

FOR IMMEDIATE RELEASE August 2, 1979

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

The Department of the Treasury has accepted $2,000 million of the $3,137 million of tenders received from the public for the 29-3/4-year 9-1/8% Bonds of 2004-2009, auctioned today. The range of accepted competitive bids was as follows:

	Price	Approximate Yield To First Callable Date	Approximate Yield To Maturity
High -	102.36	8.88%	8.89%
Low -	101.99	8.92%	8.93%
Average -	102.13	8.91%	8.92%

The $2,000 million of accepted tenders includes $150 million of noncompetitive tenders and $1,850 million of competitive tenders (including 68% of the amount of bonds bid for at the low price) from private investors.

In addition, $396 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 August 15, 1979.

SUMMARY RESULTS OF AUGUST FINANCING

Through the sale of the three issues offered in the August financing, the Treasury raised approximately $2.4 billion of new money and refunded $7.5 billion of securities maturing August 15, 1979. The following table summarizes the results:

	New Issues						
	9% Notes 8-15-82	9% Notes 2-15-87	9-1/8% Bonds 5-15-04-2009	Nonmarketable Special Issues	Total	Maturing Securities Held	Net New Money Raised
Public	$2.8	$2.5	$2.0	$ -	$7.3	$4.8	$2.4
Government Accounts and Federal Reserve Banks	0.8	0.5	0.4	1.0	2.7	2.7	-
TOTAL	$3.5	$3.0	$2.4	$1.0	$10.0	$7.5	$2.4

Details may not add to total due to rounding.

B-1771

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FOR IMMEDIATE RELEASE August 6, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,002 million of 13-week bills and for $3,001 million of 26-week bills, both to be issued on August 9, 1979, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing November 8, 1979			:	26-week bills maturing February 7, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	97.655	9.277%	9.66%	:	95.322	9.253%	9.87%
Low	97.637	9.348%	9.73%	:	95.277	9.342%	9.97%
Average	97.644	9.320%	9.70%	:	95.288	9.320%	9.94%

Tenders at the low price for the 13-week bills were allotted 97%.
Tenders at the low price for the 26-week bills were allotted 24%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 37,095	$ 37,095	:	$ 28,330	$ 28,330
New York	3,931,875	2,525,655	:	3,965,840	2,604,565
Philadelphia	39,575	24,575	:	14,355	14,355
Cleveland	28,815	28,815	:	29,545	26,545
Richmond	27,910	22,910	:	21,780	21,780
Atlanta	42,965	42,965	:	34,975	34,975
Chicago	254,620	102,070	:	156,990	101,990
St. Louis	27,020	21,020	:	22,065	16,065
Minneapolis	8,340	8,340	:	8,380	8,380
Kansas City	72,960	29,960	:	24,350	24,350
Dallas	16,480	16,480	:	11,380	11,380
San Francisco	355,445	115,145	:	324,805	77,205
Treasury	26,620	26,620	:	30,615	30,615
TOTALS	$4,869,720	$3,001,650	:	$4,673,410	$3,000,535
Type					
Competitive	$2,970,370	$1,102,300	:	$2,573,485	$ 900,610
Noncompetitive	491,480	491,480	:	349,225	349,225
Subtotal, Public	$3,461,850	$1,593,780	:	$2,922,710	$1,249,835
Federal Reserve and Foreign Official Institutions	$1,407,870	$1,407,870	:	$1,750,700	$1,750,700
TOTALS	$4,869,720	$3,001,650	:	$4,673,410	$3,000,535

1/Equivalent coupon-issue yield.

B-1772

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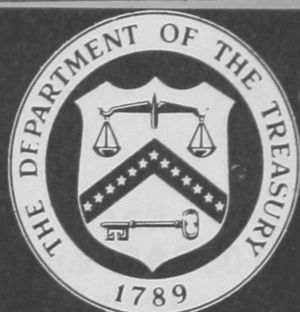

FOR RELEASE AT 4:00 P.M. August 7, 1979

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 August 16, 1979. This offering will provide $100 million of new cash for the Treasury as the maturing bills are outstanding in the amount of $5,915 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 May 17, 1979, and to mature November 15, 1979 (CUSIP No. 912793 2V 7), originally issued in the amount of $3,017 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated August 16, 1979, and to mature February 14, 1980 (CUSIP No. 912793 3R 5).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing August 16, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,936 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, August 13, 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-1773

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. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. 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. 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, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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 on August 16, 1979, in cash or other immediately available funds or in Treasury bills maturing August 16, 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.

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