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SHINGTON, D.C. 20220 TELEPHONE 566-2041

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EXPECTED AT 10:00 a.m.
March 3, 1980

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

Mr. Chairman and Members of the Committee:

I am here today to advise you of the Treasury's financing needs through fiscal year 1981. I am also requesting an increase in the authority to issue long-term securities in the market and removal of the statutory interest rate ceiling on savings bonds.

Financing Requirements

The present temporary debt limit of $879 billion will expire on May 31, 1980, and the debt limit will then revert to the permanent ceiling of $400 billion. As part of the Congressional budget, the May Budget Resolution in the House of Representatives, therefore, must include an increase in the debt limit to permit the Treasury to borrow to refund maturing securities and to pay the Government's other legal obligations for the remainder of fiscal year 1980.

Our current estimates of the amounts of debt subject to limit at the end of each month through the fiscal years 1980 and 1981 are shown in the attached table. The table indicates that the debt subject to limit will increase to $887 billion on September 30, 1980, and to $934 billion on September 30, 1981, assuming a $15 billion cash balance on these dates. These estimates are consistent with the budget estimates which the President submitted to Congress on January 28. The usual $3 billion margin for contingencies would raise these amounts to $890 billion in September 1980, and $937 billion in September 1981. Thus, the present debt limit of $879 billion should be increased by $11 billion to meet our financing requirements through the remainder of fiscal 1980 and by an additional $47 billion to meet the requirements through fiscal 1981.

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Let me emphasize the importance of timely Congressional action on the May budget resolution. In mid-May the Treasury expects to announce offerings of new note issues to refund obligations which mature on May 31 and perhaps to raise new cash. Since May 31 is a Saturday the obligations maturing on May 31 cannot be paid off or refunded until Monday, June 2, at which time the present debt limit authority will have expired. Moreover, we will also need to announce and auction Treasury bill issues in the third or fourth weeks of May. These do not settle until the first week of June. Thus, without an increase in the debt limit by mid-May, we will be forced to postpone offerings because delivery of the securities in early June could not be assured. Failure to offer these securities as scheduled could be disruptive of the Government securities market and costly to the Treasury.

Investors as well as dealers in Government securities base their day-to-day investment and market strategies on the expectation that the Treasury will offer and issue the new securities on schedule. Delayed action by Congress on the budget resolution and thus on the debt limit, therefore, would add to market uncertainties, and any such additional risk to investors is generally reflected in lower bids in the Treasury's auctions and consequently in higher costs to the taxpayer.

I know that this Committee has made every effort in the past to assure timely action by Congress to increase the debt limit. Yet, the record of recent years has not been good. On three of the last five debt limit bills action was not taken before the expiration date, and the Treasury was unable to borrow until the Congress acted two or three days later. Significant costs were incurred by the Treasury, and extraordinary measures were required to prevent the Government from going into default. The Treasury was required to suspend the sale of United States savings bonds, and people who depend upon social security checks and other Government payments suddenly realized that the Treasury simply could not pay the Government's bills unless it was authorized to borrow the funds needed to finance the spending programs previously enacted by Congress.

You would agree, I trust, that it is essential that we do everything possible to maintain the confidence of the American people in their Government. Confidence in the management of the Government's finances was seriously undermined each time the debt limit was allowed to lapse, and we must all work to avoid that outcome in this instance.

Bond Authority

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

Under this Administration, the Treasury has emphasized debt extension as a primary objective of debt management, a policy which we believe to be fundamentally sound. This policy has caused a significant increase in the average maturity of the debt, reversing a prolonged slide which extended over more than 10 years. In mid-1965 the average maturity of the privately-held marketable debt was 5 years, 9 months. By January 1976 it had declined to 2 years, 5 months, because large amounts of new cash were raised in the bill market and in short-term coupon securities. Since that time, despite the continuing needs for cash of the Federal Government, Treasury has succeeded in lengthening the debt to 3 years, 8 months, currently.

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

Congress has increased the Treasury's authority to issue long-term securities without regard to the 4-1/4 percent ceiling a number of times in recent years, and in the debt limit act of September 29, 1979, it was increased from $40 billion to the current level of $50 billion. To meet our requirements for the remainder of the fiscal year 1980, the limit should be increased to $54 billion; and to meet our requirements in the fiscal year 1981, the limit should be increased to $70 billion.

The Treasury to date has used about $44 billion of the $50 billion authority, which leaves the amount of unused authority at about $6 billion. While the timing and amounts of future bond issues will depend on prevailing market conditions, a $20 billion increase in the bond authority would permit the Treasury to continue its recent pattern of bond issues throughout fiscal year 1981. We are currently issuing long-term securities at an annualized rate of approximately $14 billion.

Savings Bonds

In recent years, Treasury has recommended frequently that Congress repeal the ceiling on the rate of interest that the Treasury may pay on U.S. Savings Bonds. In the debt limit Act of April 2, 1979, Congress increased the statutory ceiling from 6 percent to 7 percent. Since April, the Treasury has increased the savings bond rate twice: to 6-1/2 percent effective June 1, 1979, and to 7 percent for the new series EE bonds which went on sale on January 1, 1980. Legislation is necessary to provide for further increases beyond the present 7 percent statutory ceiling.

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

The Treasury relies on the savings bond program as an important and relatively stable source of long-term funds. On that basis, we are concerned that participants in the payroll savings plans and other savings bond purchasers might drop out of the program if the interest rate were not maintained at a level reasonably competitive with comparable forms of savings. In this regard, market interest rates have increased substantially since the current 7 percent ceiling was established in April, 1979, and are currently at historic highs. This has caused a significant increase in savings bond redemptions last year. In 1978, as market rates of interest increased, redemptions began to exceed sales. The cash outflow increased to $5.3 billion in 1979 and was a record $1.7 billion in January 1980. These cash losses to the Treasury must be made up by increasing the amounts the Treasury borrows in the market, and the Treasury is currently paying significantly higher interest rates on its market borrowings. If this situation continues, it will be essential to increase the savings bond interest rate in order to avoid further substantial cash drains to the Treasury and permanent damage to the savings bond program. The amount of any necessary rate increase will depend on current market conditions and on the other terms and conditions offered to savings bonds investors. We are currently reviewing the savings bonds program to determine what changes need to be made. Thus, we are requesting that the present ceiling on the savings bond interest rate be repealed.

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

Debt Limit Process

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

Separate legislation for a statutory debt limit is not an effective way for Congress to control the debt. The increase in the debt each year is simply the result of earlier decisions by Congress on the amounts of Federal spending and taxation. Consequently, the only way to control the debt is through firm control over the Federal budget. In this regard, the Congressional Budget Act of 1974 greatly improved Congressional budget procedures and provided a more effective means of controlling the debt. That Act requires Congressional concurrent resolutions on the appropriate levels of budget outlays, receipts, and public debt. This new budget process thus assures that Congress will face up each year to the public debt consequences of its decisions on taxes and expenditures.

The debt limit act of September 29, 1979, which established the current limit of $879 billion, also amended the rules of the House of Representatives to tie the establishment of the debt limit to the Congressional budget process. Under the new House Rules, the vote by which the House adopts a budget resolution will be deemed to be a vote in favor of a joint resolution changing the statutory debt limit to the amount specified in the budget resolution. The joint resolution on the debt limit will then be transmitted to the Senate for further legislative action.

Mr. Chairman, I would like to express our appreciation and support for this significant reform in the debt limit process. This new procedure will assure a more effective focus by Congress on the total budget and debt process and more timely action by Congress on the debt limit.

Attachment

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ESTIMATED
PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1980

Based on: Budget Receipts of $524 Billion,
Budget Outlays of $564 Billion,
Unified Budget Deficit of $40 Billion,
Off-Budget Outlays of $17 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1979		ACTUAL	
September 28	$24.2	$828	
October 31	10.5	828	
November 30	5.6	835	
December 31	15.9	846	
1980			
January 31	16.6	849	
February 26	13.0	853	
		ESTIMATED	
March 31	15.0	867	870
April 30	15.0	869	872
May 30	15.0	881	884
June 30	15.0	871	874
July 31	15.0	878	881
August 29	15.0	889	892
September 30	15.0	887	890

ESTIMATED
PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1981
Based on: Budget Receipts of $600 Billion,
Budget Outlays of $616 Billion,
Unified Budget Deficit of $16 Billion,
Off-Budget Outlays of $18 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1980			
October 31	$15	$900	$903
November 30	15	909	912
December 31	15	910	913
1981			
January 30	15	910	913
February 27	15	920	923
March 31	15	930	933
April 30	15	935	938
May 29	15	940	943
June 30	15	934	937
July 31	15	936	939
August 31	15	940	943
September 30	15	934	937

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March 3, 1980

Treasury Secretary G. William Miller today announced that Deputy Secretary Robert Carswell will oversee the activities of the Office of the Under Secretary for Monetary Affairs until appointment of a successor to Anthony M. Solomon who resigned to become President of the Federal Reserve Bank of New York.

Secretary Miller stated that Assistant Secretary for International Affairs C. Fred Bergsten, and Assistant Secretary for Domestic Finance Roger C. Altman will have broadened responsibilities during the interim period and will report to him through Mr. Carswell.

Mr. Carswell was nominated by President Carter as Deputy Secretary in March, 1977 and confirmed by the Senate a month later. Previously, he was a partner in the New York law firm of Shearman and Sterling. He served as Special Assistant to the Secretary of the Treasury from 1962 to 1965.

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FOR IMMEDIATE RELEASE March 3, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,300 million of 13-week bills and for $3,300 million of 26-week bills, both to be issued on March 6, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 5, 1980			26-week bills maturing September 4, 1980		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	96.259 a/	14.800%	15.59%	92.600 b/	14.637%	16.03%
Low	96.135	15.290%	16.13%	92.479	14.877%	16.31%
Average	96.174	15.136%	15.96%	92.522	14.792%	16.21%

a/ Excepting 4 tenders totaling $2,165,000
b/ Excepting 2 tenders totaling $755,000
Tenders at the low price for the 13-week bills were allotted 71%.
Tenders at the low price for the 26-week bills were allotted 78%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 69,970	$ 39,970	$ 68,685	$ 38,685
New York	4,543,200	2,553,700	5,388,460	2,789,260
Philadelphia	31,035	31,035	17,400	17,400
Cleveland	87,785	84,735	54,525	41,525
Richmond	36,215	36,215	40,875	40,875
Atlanta	66,690	66,690	45,350	45,350
Chicago	313,435	133,435	379,360	94,545
St. Louis	25,890	25,890	18,090	15,090
Minneapolis	6,305	6,305	6,305	6,305
Kansas City	49,965	49,965	46,545	46,535
Dallas	21,440	21,440	15,170	14,170
San Francisco	382,145	197,145	251,160	100,160
Treasury	53,675	53,675	50,485	50,485
TOTALS	$5,687,750	$3,300,200	$6,382,410	$3,300,385
Type				
Competitive	$3,812,005	$1,424,455	$4,475,660	$1,393,635
Noncompetitive	764,425	764,425	535,850	535,850
Subtotal, Public	$4,576,430	$2,188,880	$5,011,510	$1,929,485
Federal Reserve	877,650	877,650	870,000	870,000
Foreign Official Institutions	233,670	233,670	500,900	500,900
TOTALS	$5,687,750	$3,300,200	$6,382,410	$3,300,385

1/Equivalent coupon-issue yield.

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DATE: March 3, 1980

	13-WEEK	26-WEEK
TODAY:	15.136%	14.792%
LAST WEEK:	13.700%	13.629%
HIGHEST SINCE:		
	EVER	EVER
LOWEST SINCE:		

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FOR RELEASE UPON DELIVERY
Expected at 9:30 A.M.

STATEMENT OF
HARRY L. GUTMAN
DEPUTY TAX LEGISLATIVE COUNSEL
BEFORE THE
SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT
OF THE
COMMITTEE ON FINANCE
March 4, 1980

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to present the views of the Treasury Department on the following bills: S. 464, S. 1194, S. 1859, S. 2167, S. 2201, S. 2275, H.R. 4746 and section 4 of H.R. 5973.

Summary of Positions

S. 464 would amend the targeted jobs credit to expand the categories of target groups to include "displaced homemakers." The Treasury Department recommends that consideration of S. 464 be deferred.

S. 1194 would exclude from coverage under the Federal Unemployment Tax Act (FUTA) the services of fishermen who are employed on a fishing boat with an operating crew of fewer than 10 individuals and who do not receive cash remuneration except for a share of the boat's catch. The Treasury Department is opposed to S. 1194.

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S. 1859 and S. 2201 would permit the use of crop share rentals in the estate tax special use valuation formula. The Treasury Department is opposed to both S. 1859 and S. 2201. However, if amended as described below, the Treasury would not oppose the bills.

S. 2167 would provide that the taxable income of a homeowners association would be taxed at the graduated rates prescribed for corporations. The Treasury Department is opposed to S. 2167.

S. 2275 would make a number of technical changes in the Internal Revenue Code provisions governing General Stock Ownership Corporations (GSOC's). The Treasury Department does not oppose this bill.

H.R. 4746--Miscellaneous Changes

Section 1 of H.R. 4746 would simplify the private foundation return and reporting requirements and make private foundation information returns more readily accessible to the public. The Treasury Department supports section 1.

Section 2 of H.R. 4746 would permit private foundations to reimburse government officials for certain types of foreign travel. The Treasury Department does not oppose section 2.

Section 3 of H.R. 4746 would remove the charitable contribution deduction from the computation of adjusted itemized deductions for purposes of the alternative minimum tax on a charitable lead trust where the grantor of the trust is a corporation. The Treasury Department does not oppose section 3.

Section 4 of H.R. 4746 would provide for voluntary withholding from sick pay. The Treasury Department supports section 4.

Section 5 of H.R. 4746 would allow a deduction from gross income for the repayment of supplemental unemployment compensation benefits if the repayment is required because of the receipt of trade readjustment allowances. The Treasury Department does not oppose section 5.

<u>Section 6 of H.R. 4746</u> would give state <u>auditing</u> agencies access to Federal tax return information in the hands of state <u>taxing</u> authorities for the purpose of auditing the activities of the taxing authority. The Treasury Department does not oppose section 6.

<u>Section 7 of H.R. 4746</u> would extend the investment tax credit to the International Maritime Satellite Organization ("INMARSAT"). The Treasury Department does not oppose section 7.

<u>Section 8 of H.R. 4746</u> would allow the interest rate on retirement plan bonds and individual retirement bonds to be increased. The Treasury Department does not oppose section 8.

<u>H.R. 5973</u>

<u>Section 4 of H.R. 5973</u> would provide a limited exception to the definition of "acquisition indebtedness" for purposes of determining whether the disposition of real property by a tax-exempt organization gives rise to taxable unrelated debt-financed income. This section would benefit the Tillamook County Young Men's Christian Association of Tillamook, Oregon. The Treasury Department opposes section 4 of H.R. 5973.

* * * *

<u>S. 464 -- Targeted Jobs Credit for Displaced Homemakers</u>

Under the targeted jobs credit provisions of the Revenue Act of 1978, an employer may elect to claim a credit for certain wages paid to an individual who qualifies as a member of any one of seven target groups. The purpose of the credit is to encourage prospective employers to hire members of these disadvantaged groups.

S. 464 would expand the categories of target groups for whom the credit is available to include a new group, "displaced homemakers," as defined in paragraph (7) of section 3 of the Comprehensive Employment and Training Act Amendments of 1978. A "displaced homemaker" is there defined as an individual who:

(1) has not worked in the labor force for a substantial number of years but, during those years, has provided unpaid services for family members in the home,

(2) either has been dependent on public assistance or the income of another family member but is no longer supported by that income, or is receiving public assistance on account of dependent children in the home, and

(3) is either unemployed or underemployed and experiencing difficulty in obtaining or upgrading employment.

S. 464 would be retroactive, applying with respect to amounts paid or incurred after December 31, 1978, in taxable years ending after that date.

The targeted jobs credit was enacted as an experimental program with a three-year life. (The three-year duration assumes enactment of H.R. 2797, the Technical Corrections Act of 1979.) There was substantial debate within the Congress concerning target groups. The result of this debate, which reflected the considered judgment of the Congress, was the designation of seven target groups.

After the enactment of the Revenue Act of 1978, representatives of a number of other relatively disadvantaged groups sought to have their groups added to the list of eligible target groups. Many of these additions may be meritorious. However, in order to ensure that each receives the thorough consideration to which it is entitled, we believe all proposed amendments that would produce significant changes in the present provisions of the targeted jobs credit should be considered together. For this reason, and because we believe a large number of individuals would be included in the new target group, the Treasury Department believes that consideration of S. 464 should be deferred in favor of a more comprehensive examination of the targeted jobs credit when the current program has been in effect for three years.

In your consideration of this program, the Treasury Department requests that retroactive effective dates, such as provided in S. 464, be deleted. The targeted jobs credit is intended to be an incentive for employers to hire certain individuals who qualify as members of target groups. Providing a retroactive effective date for wages paid to members of a new target group hired before the date of amendment would clearly be inconsistent with this purpose. The credit could not have affected an employer's decision to hire these individuals.

* * * *

S. 1194 -- FUTA Exemption for Certain Fishermen

S. 1194 would amend section 3306(c) of the Internal Revenue Code of 1954 to exclude from the definition of covered employment under the Federal Unemployment Tax Act (FUTA) service performed by crew members of certain fishing vessels. The amendment would exempt the owners or operators of fishing boats from the payment of FUTA taxes if there are normally fewer than 10 crew members on the boat, the crew members do not receive cash remuneration except for either a share of the catch or a share of the proceeds from the sale of the catch, and each crew member's share depends on the amount of the boat's catch. These crew members would then not be considered to be employees of the fishing boat operators, and it is likely that they would not be eligible for unemployment benefits.*

This provision is patterned after sections 3121(b)(20) and 3401(a)(17) of the Code, which were enacted in 1976 and provide the same exclusion from taxation for purposes of the Federal Insurance Contributions Act (FICA) and income tax withholding, respectively. The intent of S. 1194 appears to be to make the treatment of fishermen consistent for the purposes of Social Security, income tax withholding and unemployment compensation.

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* The proposed exclusion would be in addition to, and not a substitute for, the present fishermen exclusion under section 3306(c)(17) of the Code. Under section 3306(c)(17), the employers of fishermen are not exempt under FUTA from the payment of Federal unemployment taxes if the services performed are related to the catching of salmon or halibut for commercial purposes, or if the services are performed on vessels of more than 10 net tons. S. 1194 would thus broaden the exclusion of fishermen under FUTA to include fishermen on vessels that exceed 10 net tons and commercial salmon or halibut fishermen.

Historically, maritime workers have had unique employment relationships, but under maritime law, which is applied in determining their status for employment tax purposes, captains and crew members are nearly always considered to be employees of the owners of the vessels. Thus, this bill would unfairly relieve employers from paying the FUTA tax for the services of crew members, but would not alter their existing employer-employee relationships which, in fact, do not reflect self-employment.

Further, the consequences of a FUTA exclusion would be more detrimental to the individual worker than the FICA exclusion under present law. Individual crew members excluded from the term "employment" under FICA will nevertheless be covered under the Social Security system as self-employed individuals. By contrast, such crew members, if excluded from FUTA coverage, could not obtain unemployment compensation coverage as self-employed persons, since all States provide that only employers may elect coverage of services performed for them. Exclusion of these workers from FUTA coverage by their employers, unlike the FICA exclusion, would therefore leave such workers without any protection, if, as experience has demonstrated, a Federal exclusion is quickly followed by State exclusions.

We believe there was good reason for limiting the 1976 changes in the employment status of fishermen to the Social Security and withholding tax provisions of the Code. The change proposed in S. 1194 is not in the best interest of the individual workers. Furthermore, this bill involves the broader issue of whether workers employed under unusual earnings agreements, such as those described in the bill, should be excluded from unemployment compensation coverage. The National Commission on Unemployment Compensation is currently undertaking a study of policies regarding unemployment compensation coverage. Consequently, Federal action, if any, on S. 1194 should be deferred pending the issuance of a report from the National Commission. For these reasons, the Treasury Department opposes S. 1194.

* * *

S. 1859 and S. 2201-- Estate Tax Special Use Valuation for Farms

Where a "family farm" contributes a large part of a decedent's estate, the estate may now take advantage of a special valuation method intended to determine the value of the land for use in farming (special use valuation) even if someone would pay more to use the land for non-farm purposes.

S. 1859 and S. 2201 each would amend the formula method of valuing farms under the special use valuation provision to permit in-kind or crop share rentals to be taken into account.

The Treasury objects to the bills in their current form. However, we would not object if the changes described below were made as well.

Under the estate tax laws in effect prior to 1976, all property was included in a decedent's gross estate at its fair market value. Fair market value did not necessarily reflect use of the property for farming if the farm land could have been used for other, more profitable, commercial purposes. In such cases, the estate tax was higher than the tax would be if the land were valued solely as a farm.

In 1976, Congress changed the law to allow special valuation of farm property for estate tax purposes. This provison (section 2032A of the Code) allows valuation on the basis of the use of the property as a farm.

Section 2032A includes two methods for valuing family farms. The first method involves the use of a mathematical formula, and is intended to minimize subjectivity in farm valuation. The second method, available to all property which is eligible for special use valuation (i.e., farms and real estate used in certain closely-held businesses), involves the application of a list of commonly accepted appraisal factors to the property, including the capitalization of income from the property.

An example may help to illustrate the 1976 change in the law, the issue addressed by S. 1859 and S. 2201, and the problem we have with the current law.

Farmer A has a farm about 20 miles outside of Washington, D.C. which he actively manages. A has received offers of $1,000 an acre for his land from farmers in the vicinity who want to use his land for farming. However, A knows that other farmers in the area have sold their land to real estate developers for condominiums and shopping centers at $1,500 per acre.

If Farmer _A_ had died before December 31, 1976, then the Internal Revenue Service could have argued that his farm land should be valued for estate tax purposes at $1,500 per acre because that was the price that developers were willing to pay.

Section 2032A was added to the Code to prevent the $1,500 valuation of Farmer _A_'s land. To illustrate, if under the application of commonly accepted appraisal factors, the value of _A_'s farm land, used as farm land, is $1,000 per acre (also the amount other farmers, who would have continued to use the land in farming, were willing to pay _A_ for his land), section 2032A enables the executors of Farmer _A_'s estate to reduce the estate tax valuation. However, to do so the executors are required to engage in a factual determination involving some subjective factors. The formula method of valuation in section 2032A avoids this subjectivity.

The formula starts with the average annual gross _cash rental_ for comparable land and subtracts the average state and local real estate taxes of comparable land. The result is then divided by the average annual effective interest rate for all new Federal Land Bank loans and the result is the value of the farm for estate tax purposes.

Two problems arise under the formula, one which the sponsors of S. 1859 and S. 2201 seek to remedy and another which concerns the Treasury.

The problem addressed by each bill is the limitation of the formula to areas where there are gross _cash rentals_ for comparable land. In many areas of the country, farm land is rented on an "in-kind" or crop share basis, rather than for cash. In these areas, the mathematical formula is not available. In other words, if land comparable to _A_'s was not rented for cash, _A_'s estate would not be entitled to use the formula. While the land may nonetheless be valued under section 2032A by using the commonly accepted appraisal approach, this method is not as simple or as objective as the formula.

The formula is designed to produce a farm use value roughly equivalent to that which would be derived by appraisal. However, as currently stated, the formula significantly understates farm use value. This occurs because the interest rate, which is the effective interest rate charged by the Federal Land Bank, is too high. For example, assume a realistic four percent interest rate would be applied under the appraisal factor method to determine that Farmer _A_'s land was worth $1,000 per acre as farm land.

The mathematical formula would give a value to the land of less than $500 per acre, a more than 50 percent reduction from the appraised value of the land for farming. Thus, the formula reduces Farmer A's estate taxes far below the amount intended by section 2032A.

This example is neither unusual nor overstated. Filings with the IRS show that farms having no potential use other than farming are nonetheless being valued at a substantial discount under the formula. Of 54 Internal Revenue Service offices reporting values determined by estate executors (not by the IRS) in a nationwide survey (attached as Appendix A), 20 offices reported average values below 40 percent of the fair market value of the land as a farm. The remaining offices also reported substantial discounts. In some areas, the executor's own calculation of the discount from the value of the land as farm land has been as high as 80 percent. We believe that even these figures do not fully reflect the effect of this discount since in most examined cases, fair market value as reported by the executor has been found to be lower than the finally agreed value. Indeed, section 2032A was estimated to cost $14 million per year when enacted. However, current figures show that unless this problem is corrected, the cost may be as much as $140 million per year.

We recognize that the goals of simplicity and objectivity will be more readily achieved if the simple, mathematical formula approach is expanded. Although the calculation of the value of in-kind or crop share rentals will introduce an element of subjectivity into the formula, we are willing to accept this approach if the formula is revised so that it will reflect more clearly the value of the farm as farm land.

We believe the undervaluation problem in the current formula can be remedied by providing a more realistic rate of capitalization. We would propose that the interest rate in the denominator of the formula be changed to equal the greater of four percent or the annual rate of return on equity from farm property. The annual rate of return on equity would be derived from two statistical tabulations prepared and published annually by the Department of Agriculture, "State Farm Income Statistics" and "The Balance Sheet for The Farming Sector." Specifically, the rate of return on equity from farm production would be determined, on a state-by-state basis, by subtracting government payments from net farm income and dividing the result by proprietors' equities. Each of these three figures is readily available from Department of Agriculture publications. The Agriculture Department data would guarantee a fair value based upon the land's use as farm. It would not increase the value to reflect non-farm use or reduce the value by using an unrealistic interest rate. It would not decrease the number of estates eligible to use the formula or take away any of the objectivity or certainty currently available in applying the formula. In other words, this proposal would merely modify the formula so that the valuation of a farm under the formula would reflect more accurately the farm's fair market value as a farm.

If S. 1859 or S. 2201 were amended to include this change in the interest rate, we would not object to either bill.

* * * *

S. 2167--Rate of Tax on Homeowners Associations

S. 2167 would amend Code section 528, relating to certain real estate management and condominium associations ("homeowners associations"), so that tax would be imposed on such associations at the graduated rates for corporations. Currently, the income of a homeowners association is taxed at the "highest rate of tax" for corporations, 46 percent. The Treasury Department is opposed to S. 2167.

Section 528 was added by the Tax Reform Act of 1976. It was enacted to insure that participants in homeowners associations could arrange to defray collectively the expenses of maintaining their personal residences, without being subjected to more onerous tax treatment than those who paid directly the expenses of maintaining their homes. Before 1976, it was unclear whether corporations organized as condominium or residential real estate management associations would be treated as exempt organizations or associations taxable as corporations. If taxed as corporations, homeowners who maintained homes through an association would be taxed twice, once when they earned the income and a second time when it was received by the corporation.

To alleviate this uncertainty Congress enacted Code section 528. That section essentially provides that an eligible, electing association will not be taxed on amounts received from members to defray the expenses of maintaining common property. However, this exemption would offer an opportunity for tax advantage if homeowners were permitted to contribute portfolio assets to the homeowners association and use the tax-free income from those investments to defray the expenses of maintaining their residences. Similarly, a homeowners association might be used as a shield for the conduct of an unrelated business, the pre-tax profits from which could be applied to the maintenance of the participants' common expenses. Accordingly, the statute provides that all income derived by a homeowners association, other than through dues, fees or assessments received from its members, is to be taxed to the association as a corporation.

Before the Revenue Act of 1978, which added the graduated rate schedule for corporations, a homeowners association was taxed on its income without allowance for the pre-1979 surtax exemption. Out of consistency with the statute as it existed before 1979, therefore, homeowners associations were not permitted to use the graduated rate schedule.

Taxation of investment or trade or business income of a homeowners association is essentially a surrogate for attributing the income to members of the association and taxing it at their individual marginal rates. Where the average rate of the participants is less than the 46 percent top corporate rate, the income of the association might be said to be "overtaxed." Where the average rate of the participants exceeds the 46 percent top corporate rate, even without the change by S. 2167, the association income would, in effect, be undertaxed.

Short of conduit treatment, there is no absolutely correct solution to this problem. However, there is no particular reason to encourage homeowners associations to have large investment portfolios. 'Application of the graduated corporate rate would, in many cases, subject association income to tax at rates lower than those of the participants. It would, therefore, encourage accumulation of investment assets. By the same token, use of the top corporate tax rate would discourage accumulation and eliminate any incentive to shift income from one year to the next to achieve taxation at a lower rate. On balance we believe the latter course is preferable.

Finally, the rationale for enacting a graduated corporate rate was to encourage capital formation, particularly in the hands of small business. That rationale furnishes no justification for imposing a graduated rate on homeowners associations which are not organized as profit-making enterprises.

The Treasury Department therefore opposes S. 2167.

* * * *

S. 2275 -- GSOC Technical Corrections

S. 2275 makes a number of technical corrections in the provisions of the Code (sections 1391-1397) governing General Stock Ownership Corporations ("GSOC's"). These provisions were added to the Code as part of the Revenue Act of 1978.

In general, a GSOC is a corporation which is established and owned by the residents of a state and which is intended to borrow funds to acquire profitable enterprises for the benefit of the residents. The income of the GSOC is taxed on a pass-through basis to the resident-shareholders and not to the GSOC.

Most of the changes made by this bill merely correct typographical and other errors. In addition, two of the changes fill gaps in the statutory scheme so as to facilitate a GSOC's ability to function as intended.

First, the GSOC provisions now prohibit transfers of GSOC shares to any individual who is not a resident of the chartering state, thus appearing to prohibit the transfer of shares to an estate upon the death of a shareholder. The bill corrects this oversight.

Second, the Code requires that at least 90 percent of a GSOC's taxable income be distributed to the shareholders, who are taxable on 100 percent of the GSOC's income whether or not it is distributed to them. A penalty tax of 20 percent is imposed on any shortfall in this distribution requirement. The legislative history indicates that this penalty tax is to be deductible by the GSOC in computing its taxable income, but the statute is silent. The bill remedies this inconsistency by expressly providing for deductibility. If the penalty tax were not so deductible, the shareholders would be taxed on the amount of the tax, even though they had not received a distribution of that amount.

The Treasury Department is not opposed to S. 2275.

* * * *

H.R. 4746-- Miscellaneous Changes

Section 1 of H.R. 4746--Simplification of Private Foundation Reporting Requirements

Under current law, private foundations are required to file both an annual return and an annual report. In addition, non-exempt charitable trusts which have solely charitable beneficiaries are subject to different return and disclosure requirements from those applicable to exempt charitable trusts and organizations.

Section 1 of H.R. 4746 would consolidate the two reporting requirements for private foundations into one return requirement. The requirement to file an annual report would be eliminated. In addition, non-exempt wholly charitable trusts would be required to file the same report as private foundations, thereby consolidating certain requirements and making the information returns of such trusts subject to public disclosure. Finally, the proposal would provide that a private foundation would not be required to list on its return the name and address of a needy or indigent recipient receiving grants of less than $1,000 in any year.

The Treasury Department supports section 1 of H.R. 4746.

Section 2 of H.R. 4746--Private Foundation Reimbursements

Under current law, a private foundation is prohibited from engaging in certain self-dealing transactions. Self-dealing transactions include payments to a government official. A limited exception is provided which permits the payment or reimbursement of traveling expenses of a government official solely from one point in the United States to another point in the United States. This exception does not allow for the payment or reimbursement of traveling expenses outside the United States.

Section 2 of H.R. 4746 would expand this exception to provide that a foundation may reimburse a government official for travel between a point in the United States and one outside the United States. The bill further includes limitations on the availability of the exception which are similar to those under current law in the area of expenses for domestic travel.

The Treasury Department does not oppose section 2 of H.R. 4746.

Section 3 of H.R. 4746--Alternative Minimum Tax on Charitable Lead Trust with Corporate Grantor

Under the alternative minimum tax, capital gains and adjusted itemized deductions constitute the two tax preferences. The latter preference excludes a number of itemized deductions and the remaining itemized deductions are preferences to the extent they exceed 60 percent of adjusted gross income less the excluded deductions.

Although trusts and estates are generally subject to the alternative minimum tax, certain charitable contributions of trusts and estates are treated favorably for minimum tax purposes. For example, charitable contributions are considered untainted in the case of certain wholly charitable trusts, pooled income funds and testamentary lead trusts. However, there is generally no exception for the charitable deductions of *inter vivos* lead trusts.

Section 3 of H.R. 4746 would provide that the charitable deductions of a charitable lead trust will not be considered in determining the adjusted itemized deduction preference for purposes of the alternative minimum tax if the grantor of the trust and the owner of all reversionary interests in the trust is a corporation.

The Treasury does not oppose section 3 of H.R. 4746.

Section 4 of H.R. 4746--Voluntary Withholding Under Wage Continuation Plans

Under present law amounts received by an employee through accident or health insurance for personal injuries or sickness generally are includible in gross income to the extent such amounts (1) are attributable to contributions by the employer which are not includible in the gross income of the employee, or (2) are paid by the employer.

Withholding is not required on sick pay payments provided by third parties, such as insurance companies, even if the recipient so requests.

Section 4 of H.R. 4746 provides that a taxpayer who is to receive sick pay may request that the third party paying such amount withhold a specified percentage (but no less than the minimum prescribed by regulations) from these payments. A number of special rules relating to the information which must be provided to the third party payor, the treatment of requests under collective bargaining agreements and the timing of information reporting on these withheld amounts are included in the provision.

The Treasury Department supports section 4 of H.R. 4746.

Section 5 of H.R. 4746--Repayments of Supplemental Unemployment Compensation Benefits

Under current law a worker who receives supplemental unemployment compensation benefits (SUB) payments under a claim of right is entitled to a loss deduction if the taxpayer is required to repay the SUB payments in a subsequent year. Alternatively, if the SUB payment exceeds $3,000, the worker may elect to reduce taxes in the year of repayment by the amount of the decrease in the prior year's (or years') taxes which will result from the exclusion of the SUB payment from gross income in the prior year (or years).

Section 5 of H.R. 4746 would allow the loss deduction for a repayment of a SUB payment which is required on account of the receipt of a trade readjustment allowance ("TRA") to be taken into account in computing adjusted gross income under the Code. As under present law, the deduction would be taken in the year of repayment.

The Treasury Department does not oppose section 5 of H.R. 4746.

Section 6 of H.R. 4746--Disclosure of Federal Tax Information to State Auditing Agencies

The Internal Revenue Code currently gives state auditing agencies access to Federal tax return information only when the agency is actually involved in the determination, assessment, collection or refund of taxes (i.e., tax administration activities), and not when the agency's role is limited to general oversight of the taxing authority.

Section 6 of H.R. 4746 would amend the Code to give state auditing agencies access to Federal tax return information in the hands of state taxing authorities for purposes of tax administration and for the purpose of auditing the activities of the taxing authority.

The Treasury does not oppose section 6 of H.R. 4746.

Section 7 of H.R. 4746--Investment Tax Credit for INMARSAT

Under current law, the investment tax credit is not generally available for property used outside the United States or for propety used by an international organization.

Section 7 of H.R. 4746 would make the investment tax credit available for the interests of United States persons in communications satellites used by the International Maritime Satellite Organization (INMARSAT), an international organization established to develop and operate a global maritime satellite telecommunications system.

The Treasury is not opposed to section 7 of H.R. 4746.

Section 8 of H.R. 4746--Interest on United States Retirement Bonds

Under current law, the interest rate on an individual retirement bond or a retirement plan bond remains the same from the date of issuance until the bond is redeemed. However, the interest rate on outstanding Series E Bonds is increased whenever there is an increase in the interest rate on new issues of Series E Bonds.

Section 8 of H.R. 4746 would allow the Treasury Department, with the approval of the President, to make upward adjustments in the interest rate on outstanding retirement bonds, so that such bonds would earn interest at a rate consistent with the yield for new issues of such bonds after the effective date of the interest rate increase.

The Treasury Depatment is not opposed to section 8 of H.R. 4746.

* * * *

H.R. 5973

Section 4 of H.R. 5973-- Special Rule Relating to Debt-Financed Income of Exempt Organizations

Section 4 of H.R. 5973 provides a limited exception to the definition of "acquisition indebtedness" for purposes of determining whether the disposition of real property by a tax-exempt organization gives rise to taxable unrelated debt-financed income. The Treasury opposes this provision of H.R. 5973.

In general, income that an exempt organization receives from investment property is taxable in the proportion that the property is financed by debt. If the property is sold, gain on the sale also is taxable in the proportion that the property is debt-financed. This proportion is determined by the highest "acquisition indebtedness" on the property for the twelve-month period preceding the date of disposition.

The circumstances under which the proposed exception would apply are limited and detailed. Basically, it would exclude a sale of real property during 1976 that had been financed before 1965, provided certain other narrow requirements are met.

We believe Congress clearly intended to tax sales of "debt-financed property." We also believe Congress intended that the test whether property was debt-financed at sale was to be judged by looking at the twelve-month period preceding the date of sale. An exempt organization planning to dispose of income producing property may extinguish the acquisition indebtedness on the propety and sell it without tax only after a twelve-month waiting period.

These rules were enacted in 1969, and, after a transitional period, have applied to dispositions of all debt-financed property since 1972. Exempt organizations have had more than enough time to adjust to this provision and we have no reason to believe that they have not done so. We, therefore, consider the special retroactive exception of section 4 to be discriminatory and unwarranted.

* * * *

I shall be happy to answer any questions you may have.

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APPENDIX A

age Discount on Fair Market Values from Section 2032A Elections (based upon valu
rted by executors electing section 2032A and shown by IRS district)

est Region

ringfield, Illinois	62%
icago, Illinois	61%
s Moines, Iowa	50%
rgo, North Dakota	47%
lwaukee, Wisconsin	62%
aha, Nebraska	45%
. Louis, Missouri	49%
erdeen, South Dakota	47%
. Paul, Minnesota	47%

ral Region

ncinnati, Ohio	57%
eveland, Ohio	49%
troit, Michigan	62%
dianapolis, Indiana	51%
uisville, Kentucky	51%
rkersburg, West Virginia	46%

Atlantic Region

iladelphia, Pennsylvania	76%
wark, New Jersey	63%
ltimore, Maryland	60%
chmond, Virginia	55%
lmington, Delaware	59%

1 Atlantic Region

bany, New York	23%
ston, Massachusetts	67%
ooklyn, New York	42%
ffalo, New York	46%
rlington, Vermont	68%
rtford, Connecticut	70%
nhattan, New York	39%
rtsmouth, New Hampshire	32%
ovidence, Rhode Island	26%

Southwest Region

Albuquerque, New Mexico	65
Oklahoma City, Oklahoma	64
Austin, Texas	67
(Houston POD - 81%)	
Dallas Texas	64
Wichita, Kansas	39
Cheyenne, Wyoming	71
Denver, Colorado	63
Little Rock, Arkansas	44
New Orleans, Louisiana	44

Western Region

Boise, Idaho	52
Helena, Montana	47
Seattle, Washington	40
Portland, Oregon	57
Fresno, California (IRS Service Center)	55
Salt Lake City, Utah	46
Los Angeles, California	29
Phoenix, Arizona	59
San Francisco, California	40

Southeast Region

Greensboro, North Carolina	44
Jacksonville, Florida	65
Nashville, Tennessee	66
Atlanta, Georgia	43
Birmingham, Alabana	67
Columbia, South Carolina	57

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

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 AM
TUESDAY, MARCH 4, 1980

STATEMENT OF THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON TREASURY, POST OFFICE AND
GENERAL GOVERNMENT
COMMITTEE ON APPROPRIATIONS
U.S. HOUSE OF REPRESENTATIVES

Appropriation of the U.S. Contribution to the International Natural Rubber Agreement

Introduction

I am pleased to appear before you today to testify in favor of an Administration request for a $88 million appropriation for the new International Rubber Agreement. This appropriation is necessary to support U.S. membership in the International Rubber Agreement for which the Administration will be seeking the advice and consent of the Senate as well as authorizing legislation.

The Treasury Department strongly supports ratification of this Agreement and recommends approval of the appropriation at an early date to serve as an important element in the Administration's anti-inflation program. In calling attention to the need to fight inflation, President Carter has made prominent reference to international commodity trade and the potential role of international commodity agreements in contributing to the battle against inflation in the United States:

> "When prices of raw materials and food fluctuate upward, the effects tend to spread throughout the economy, raising prices and wages generally .... Reducing fluctuations in commodity prices, therefore, helps to reduce inflation."

This objective was reaffirmed in the Administration's testimony before the Senate Budget Committee recently when Secretary Miller and others stated that "properly constructed commodity agreements can provide benefits to both producers and consumers by reducing inflationary pressures, promoting greater stability and increasing incentives for primary commodity production." They went on to point out that the Rubber Agreement provides an excellent example of an international commodity arrangement which balances producer and consumer interests to their mutual benefit.

Approval of this appropriation will demonstrate the firm commitment of the U.S. Government to the Agreement and to our overall international commodity policy. It is important to note that, while this Agreement will contribute to rubber price stability, it will not provide any artificial prop for rubber prices.

My colleague from the State Department will describe the planned operation of the Agreement and details of this U.S.

contribution. I would like to focus my remarks on overall U.S. commodity policy and how the Natural Rubber Agreement is a major element of that policy.

Administration Commodity Policy

One of the early international economic policy decisions made by this Administration was to reorient U.S. policy from leaving commodity trade to the vicissitudes which are characteristic of commodity markets to seeking deliberate measures to reduce instability in prices and supplies. This reorientation reflects the Administration's continuing concern about the adverse effects of volatile commodity prices on inflation in the U.S., on the economies of all exporting and importing countries, on individual producers and consumers, and on the orderly expansion of raw material supplies.

Prices of primary commodities are exceptionally unstable and the U.S. economy experiences real costs from such price instability. For example, excessive rises in commodity prices, even when they are temporary, induce economy-wide price increases beyond the direct impact of the commodity prices themselves. This is because producers of manufactured goods and food processors often justify additional increases in their price on the basis of cost increases stemming from rising prices for their raw materials. However, these increases are not likely to be withdrawn when raw material prices subsequently recede. The effect is a ratcheting up of the general consumer price index, which in turn provides justification for higher wage increases. As inflation spreads, for this as well as other reasons, inflationary expectations then generate additional demand for business inventories and create fears of impending shortages, provoking protective purchases and forcing raw material prices up even further in a spiral which, as we saw particularly in 1973 - 1974, can be devastating.

Excessive price declines for commodities can also, paradoxically, fuel inflation over the long run. When such declines are precipitate and extended in time, they can deter investment in new productive capacity at both the primary and processing stages. Supply then becomes inadequate to meet the normal growth of demand in future years, pushing prices up at that time.

These two occurrences are peculiar to some, though not all, of the commodity markets because prices in these markets fluctuate much more sharply than do prices either of industrial products or of services.

It is often argued that the market provides the optimal degree of price stability for commodity trade. Unfortunately, this is not always the case. The direct benefits of reducing commodity price fluctuations accrue to all buyers and sellers, whether or not they individually contribute to the cost of the stabilization arrangement; hence the incentive to individual market participants to contribute to the cost of stabilization is negligible, and the market alone will not call forth the appropriate institutions. In addition, the indirect benefits of price stabilization -- notably the reduction of overall inflation rates -- extend well beyond the universe of participants in the commodity markets themselves. Thus, price stability can be considered a public good, and an appropriate target for Governmental action.

Economies of exporting countries also suffer significantly as a result of gyrating commodity prices. Many of these exporters rely heavily on commodities for their foreign exchange earnings, which are used largely to buy industrial products needed for development. The United States is among those who supply substantial amounts of exports to commodity exporting countries. In 1979, we sold $5.2 billion to natural rubber producing countries, a more than 30 percent increase over 1978. Extreme volatility in commodity prices weakens the ability of the United States to maximize our export potential to these countries.

It was against this background that the Administration decided to launch a series of steps to help contain inflationary pressures emerging from commodity markets, reduce our vulnerabilit to unreliable and uneconomic sources of supply, and enhance econom stability in producing countries. This U.S. policy embodies the following elements:

-- negotiation of international commodity agreements, where feasible, between producers and consumers to reduce excessive price volatility;

-- emphasis on buffer stocking as the preferred price stabilizing mechanism;

-- joint financial responsibility for financing such agreements;

-- promotion of increased investment in commodity industries;

-- negotiation of a Common Fund to facilitate financing of individual agreements; and

-- more effective operation of the Compensatory Finance Facility of the International Monetary Fund to buffer the effects of fluctuations in a country's export earnings.

The United States now belongs to the Coffee, Sugar and Tin Agreements, which all contain market intervention mechanisms which rely to some extent on commodity stocking to achieve their objectives. The United States joined the Coffee Agreement in the 1960s and became a member of the Tin Agreement in 1976 after participating in its negotiation a year earlier. Negotiation of the Sugar Agreement, with the United States playing a major role, took place in 1977 and the Senate ratified the Agreement late last year. The Congress early this year authorized a U.S. contribution to the Tin Agreement to stabilize prices.

Structure of the Rubber Agreement

Countries involved in exporting and importing rubber have recognized for sometime the desirability of a commodity agreement for rubber to alleviate volatile market conditions.

The volatility of rubber prices is well documented. For example, a recent World Bank study of the volatility of the prices of 40 commodities showed that rubber ranked seventh. The attached graph shows the wide fluctuations in natural rubber prices during the past 20 years. The New York price declined in an irregular fashion from 38 cents per pound in 1960 to 20 cents in 1968. It then rose to 26 cents the next year before resuming its downward trend to 18 cents in 1972. This low was followed by a new peak of 39 cents in 1974. After another sharp break to 30 cents in 1975, the price has soared, reaching nearly 80 cents a pound in mid-February. It has now dropped back to about 70 cents.

Because of their concerns about these price fluctuations, producing countries reached agreement among themselves to establish a small buffer stock and institute export controls to seek to stabilize rubber prices. It was only after importing countries demonstrated a sincere effort to negotiate a producer-consumer agreement that the producers agreed to hold their agreement in abeyance.

All countries agree that a producer-consumer arrangement would be more effective in stabilizing the natural rubber market and provide a better balance of benefits to producers and consumers. Accordingly, the producing countries have agreed to abandon their proposed agreement when the new Natural Rubber Agreement goes into force.

We believe price stabilization agreements should operate wherever possible through buffer stocks. The structure of the rubber market is well-suited to a buffer stock arrangement. Bought when prices are low, and sold when they are high within an agreed price range, buffer stocks can be more effective than any other approach in stabilizing prices without distorting markets or production patterns. In fact, we expect them to make profits to help cover operating costs.

Buffer stocks are far preferable to supply controls regarding market efficiency, operational simplicity and consumer benefits as they allow the price mechanism to allocate resources to the most efficient producers. There are three basic criteria which must be met for this, our preferred approach, to apply to a given commodity First, the international price must be established in an open market. Second, the commodity should be either non-perishable or easily rotated in storage facilities so that stock maintenance is feasible and carrying costs do not become exorbitant. Third, the commodity should be relatively homogeneous in the sense that most trading takes place in a limited number of well-defined grades whose prices move in tandem. In addition, a buffer stock must have large stocking authority, adequate financing shared by both producers and consumers, an adjustable price range, and membership by all major producers and consumers.

There is wide agreement that the natural rubber market meets these criteria. I particularly want to emphasize that this Agreement will provide for: a large buffer stock of 550,000 tons; a wide price band of plus or minus 20 percent around a reference price; and provision for adjustment of this range as market conditions change. In fact, this Agreement will come close to being a prototype commodity agreement.

Furthermore, the Agreement contains provisions under which producing countries will implement policies to ensure availability of rubber supplies and will not undertake actions which are inconsistent with the Agreement. In addition, the Council may make specific recommendations to governments on policies affecting supply and demand for rubber.

In achieving this high degree of success in negotiating an effective agreement, we need to recognize the spirit of cooperation among the participants in the conference. The major rubber producers from Southeast Asia in particular worked long and hard to assure a successful outcome. Those countries fully appreciate that stabilization will promote a more efficient industry.

Appropriation of the Contribution

As a member of the Natural Rubber Agreement, the United States will be obligated to finance its share of the costs of acquiring and operating the buffer stock. The costs of the Agreement are to be shared equally between producers and consumers. We have estimated the U.S. share will be $88 million, or about 12.5 to 15.5 percent of the total requirement. This approximates our share of trade in natural rubber. We expect that the appropriation will be on a one-time basis, and the amount of money to be paid in FY 1981 will be relatively small -- perhaps $5 million.

This small initial payment will enable the Agreement to set up its administrative machinery and begin purchasing a buffer stock quickly, if necessary. The remainder of members' contributions would be made as needed to the buffer stock manager to enable him to expand his purchases to keep prices within the price range.

We recognize that budgets must be kept tight in this difficult period, but the Administration has carefully considered the need for this appropriation and feels it is imperative that it be appropriated this year.

By doing so, the Natural Rubber Agreement, an important element in the Administration's international commodity policy will contribute to our long term fight against inflation. It will also provide benefits for the producing countries. But in order to set these mutual benefits in train, we and others must do our part by providing funding to permit the Agreement to become operational. By doing so, we are following a course similar to that established by our contribution to the Tin Agreement.

Policy Implementation

We have made substantial progress in implementing U.S. commodity policy, though the task has been long and arduous and much work remains. The successful negotiation of the Rubber Agreement is but the latest achievement in the commodity area. Other accomplishments are:

- successful negotiation and ratification of the International Sugar Agreement with its special stocking provisions;
- Congressional authorization to contribute tin to the International Tin Buffer Stock in proportion to our imports;
- a commitment by all countries to share financing of commodity agreements;
- significant progress in negotiating a Common Fund;
- action by some commodity producing countries to reexamine and, in some cases, modify their tax policies to reduce deterrents to investment in commodities;
- adoption by the multilateral development banks and our Overseas Private Investment Corporation of policies to allocate more loans to raw materials industries in developing countries; and
- liberalization of the Compensatory Finance Facility of the IMF which has resulted in gross drawings of $4.8 billion since 1975, compared with $1.2 billion in the 13 years of its prior operations.

There have been disappointments along the way in achieving these goals, but we have established precedents which should lead to future achievements.

Conclusion

In conclusion, I would like to reemphasize that the Administration is strongly committed to an international commodity policy which will help fight inflation in the United States and worldwide. We have made substantial progress in implementing it. This Natural Rubber Agreement will become a strong component of that policy, and represents a serious cooperative effort between importing and exporting countries. It will lead to the abandonment of the producer proposal for a natural rubber agreement. We expect the agreement to significantly moderate rubber price fluctuations over the long run and be well worth the modest cost to the United States.

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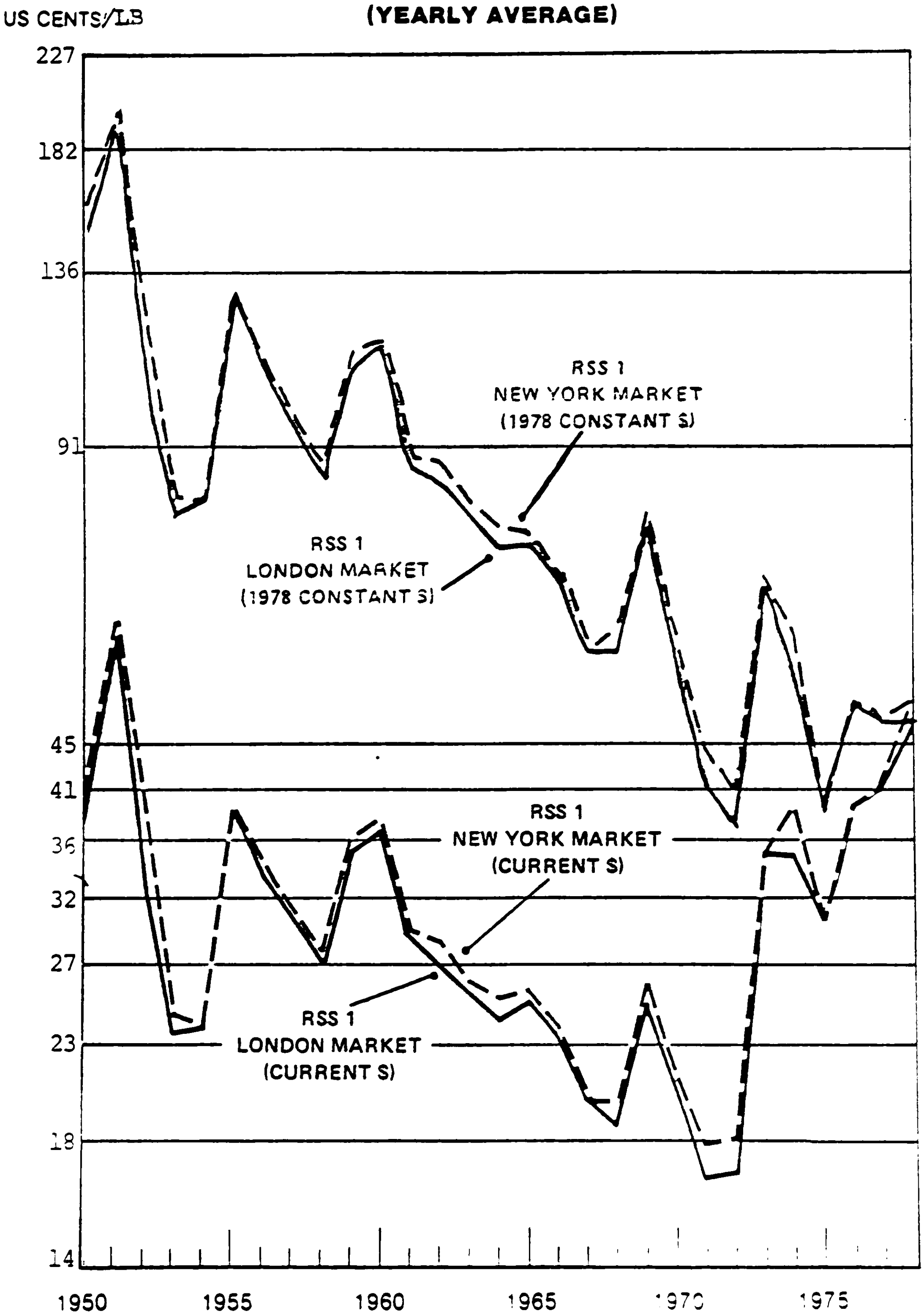
NATURAL RUBBER

(YEARLY AVERAGE)



SOURCE: Department of Treasury
World Bank Data

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

FOR RELEASE AT 4:00 P.M. March 4, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $6,600 million, to be issued March 13, 1980. This offering will provide $250 million of new cash for the Treasury as the maturing bills are outstanding in the amount of $6,352 million, including $ 950 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,844 million currently held by Federal Reserve Banks for their own account. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,300 million, representing an additional amount of bills dated December 13, 1979, and to mature June 12, 1980 (CUSIP No. 912793 4J 2), originally issued in the amount of $ 3,236 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,300 million to be dated March 13, 1980, and to mature September 11, 1980 (CUSIP No. 912793 5E 2).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing March 13, 1980. Tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the weighted average prices 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, March 10, 1980. 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

M-357

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 March 13, 1980, in cash or other immediately available funds or in Treasury bills maturing March 13, 1980. 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.

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press inquiries: 202-566-2615

FOR IMMEDIATE RELEASE March 4, 1980

FEDERAL FINANCING BANK ACTIVITY

Roland H. Cook, Secretary, Federal Financing Bank (FFB), announced the following activity for January 1-31, 1980.

Guarantee Programs

During January, FFB made 35 advances totalling $307,622,076.50 to 17 governments under loan agreements guaranteed by the Department of Defense pursuant to the Arms Export Control Act.

Under notes guaranteed by the Rural Electrification Administra-tion, FFB advanced a total of $216,534,000.00 to 26 rural electric and telephone cooperatives.

On January 23, FFB purchased a total of $4,750,000 in debentures issues by 6 small business investment companies. These debentures are guaranteed by the Small Business Administration, mature in 3, 5, 7 and 10 years, and carry interest rates of 11.135%, 11.035%, 11.085% and 11.035%, respectively.

On January 31, FFB signed Note #4 with Seven States Energy Corporation under a $2 billion nuclear fuel lease credit agreement. Note #4 is in the amount of $526,236,242.60, matures April 30, 1980, and carries an interest rate of 12.815%.

FFB provided Western Union Space Communications, Inc., with the following amounts. These advances mature October 1, 1989, and will be repaid by NASA under a satellite procurement contract with Western Union. Interest is payable on an annual basis.

Date	Amount	Interest Rate
1/2	$ 700,000.00	10.883%
1/21	6,650,000.00	11.755%
1/24	1,610,000.00	11.319%

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During January, FFB purchased the following General Services Administration public buildings interim certificates:

Date	Series	Amount	Maturity	Interest Rate
1/17	L-063	$ 88,342.33	11/15/04	10.699%
1/17	K-028	131,037.04	7/15/04	10.674%
1/17	M-055	2,978,875.35	7/31/03	10.696%
1/24	M-056	119,657.00	7/31/03	10.954%
1/30	K-029	164,020.25	7/15/04	11.255%

Department of Transportation (DOT) Guarantees

On January 3, the Milwaukee Road issued a $30 million Trustee's Certificate to the FFB. Funds advanced under this Certificate are due July 3, 1980, and are fully guaranteed by DOT pursuant to the Emergency Rail Services Act, as amended by the Milwaukee Road Restructuring Act. Under this certificate, FFB advanced $5 million on January 7, and $16,025,833 on January 18 at interest rates of 13.085% and 12.815%, respectively.

Under notes guaranteed by DOT pursuant to Section 511 of the Railroad Revitalization and Regulatory Reform Act of 1976, FFB lent funds to the following railroads:

	Date	Amount	Maturity	Interest Rate
Chicago & North Western 511-78-2	1/14	$ 290,552	5/1/86	11.110% an.
Chicago, Rock Island	1/17	1,778,898	12/10/93	11.154% an.
Chicago & North Western 511-78-3	1/17	1,254,765	11/1/90	10.831%
Chicago, Rock Island	1/18	914,697	12/10/93	11.211% an.
Missouri-Kansas-Texas RR	1/22	500,000	11/15/96	10.973% qtr.

During January, the United States Railway Association financed the following through FFB:

Date	Note #	Amount	Maturity	Interest Rate
1/9	19	$1,000,000	12/26/90	10.735%
1/18	17	4,017,500	4/29/80	12.556%

Agency Issuers

FFB advanced $90 million in new cash to the Student Loan Marketing Association, a federally chartered private corporation.

On January 31, FFB purchased a $595 million Certificate of Beneficial Ownership from the Farmers Home Administration. This certificate matures January 31, 1985 and carries an interest rate of 11.614%, payable annually.

During January the Tennessee Valley Authority sold FFB the following notes totalling $600 million and maturing April 30, 1980:

Date	Note #	Amount	Interest Rate
1/9	120	$ 25,000,000	12.697%
1/15	121	10,000,000	12.573%
1/23	122	35,000,000	12.844%
1/30	122-A	15,000,000	12.804%
1/31	123	515,000,000	12.815%

On January 31, TVA issued FFB a Power Bond, 1980 Series A, in the amount of $500 million. This bond matures January 31, 2005 and carries an interest rate of 12.815%.

On January 29, FFB pruchased Block #6 of the Department of Health, Education and Welfare-guaranteed Health Maintenance Organization notes at a price of $9,423,668.48. The notes that form Block #6 have various maturities and were purchased at a rate of 11.235%.

FFB Holdings

As of January 31, 1980, FFB holdings totalled $68.3 billion. FFB Holdings and Activity Tables are attached.

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FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)

Program	January 31, 1980	December 31, 1979	Net Change (1/1/80-1/31/80)	Net Change-FY 80 10/1/79-1/31/80
On-Budget Agency Debt				
Tennessee Valley Authority	$ 7,457.0	$ 7,272.0	$185.0	$ 332.0
Export-Import Bank	8,352.7	8,352.7	-0-	399.8
NCUA-Central Liquidity Facility	31.6	38.1	-6.5	31.6
Off-Budget Agency Debt				
U.S. Postal Service	1,587.0	1,587.0	-0-	-0-
U.S. Railway Association	440.5	436.3	4.2	-5.2
Agency Assets				
Farmers Home Administration	32,145.0	32,050.0	95.0	1,065.0
DHEW-Health Maintenance Org. Loans	94.1	84.6	9.5	16.8
DHEW-Medical Facilities Loans	160.1	160.1	-0-	-0-
Overseas Private Investment Corp.	33.6	33.6	-0-	-2.2
Rural Electrification Admin.-CBO	1,223.2	1,223.2	-0-	-0-
Small Business Administration	89.2	90.7	-1.5	-5.2
Government Guaranteed Loans				
DOT-Emergency Rail Services Act	63.4	42.4	21.0	26.0
DOT-Title V, RRRR Act	108.1	103.9	4.1	15.4
DOD-Foreign Military Sales	5,762.7	5,480.0	282.7	491.9
General Services Administration	379.9	376.4	3.5	20.2
Guam Power Authority	36.0	36.0	-0-	-0-
DHUD-New Communities Admin.	33.5	33.5	-0-	-5.0
DHUD-Community Block Grant	7.4	7.4	-0-	2.0
Nat'l. Railroad Passenger Corp. (AMTRAK)	405.6	446.4	-40.8	-26.7
Western Union Space Comm. (NASA)	464.6	455.6	9.0	44.2
Rural Electrification Administration	6,700.5	6,484.0	216.5	774.1
Seven States Energy Corp. (TVA)	562.2	526.6	35.7	562.2
Small Business Investment Companies	363.2	358.4	4.8	26.8
Student Loan Marketing Association	1,595.0	1,505.0	90.0	320.0
Virgin Islands	21.3	21.6	-0.2	-0.2
WMATA	177.0	177.0	-0-	-0-
TOTALS	$68,294.4	$67,382.5	$912.0	$4,083.4*

Federal Financing Bank — February 26, 1980

*Totals do not add due to rounding.

FEDERAL FINANCING BANK

January 1980 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
DEPARTMENT OF DEFENSE					
Israel #7	1/3	$ 6,476.69	12/15/08	10.485%	
Israel #9	1/3	186,204,955.86	12/15/09	10.474%	
Colombia #2	1/7	108,327.88	9/20/84	11.172%	
Colombia #3	1/7	1,614,595.96	9/20/85	11.064%	
Indonesia #5	1/7	12,949,793.00	7/21/88	10.889%	
Turkey #7	1/7	828,727.00	6/3/91	10.814%	
Spain #2	1/8	11,282,637.00	9/15/88	10.878%	
Colombia #3	1/10	631,347.38	9/20/85	10.947%	
Ecuador #3	1/10	18,000.00	8/1/85	10.954%	
Korea #10	1/10	2,284,595.00	12/31/87	10.806%	
Philippines #4	1/10	699,378.99	9/12/83	11.199%	
Spain #2	1/10	691,876.95	9/15/88	10.833%	
Spain #3	1/10	295,838.00	9/20/89	10.784%	
Tunisia #5	1/10	4,260,201.00	6/1/86	10.908%	
Greece #11	1/14	25,856.00	5/10/89	10.879%	
Spain #1	1/14	70,853.20	6/10/87	10.938%	
Spain #2	1/14	10,004,000.00	9/15/88	10.912%	
Spain #3	1/14	3,978,073.00	9/25/89	10.867%	
Colombia #2	1/17	117,093.50	9/20/84	11.080%	
Thailand #2	1/17	100,000.00	6/30/83	11.272%	
Indonesia #5	1/18	2,657,920.00	7/21/88	10.894%	
Israel #9	1/23	51,211,985.58	12/15/09	10.948%	
Liberia #3	1/23	20,679.48	6/30/84	11.294%	
Malaysia #3	1/24	125,848.18	3/20/84	11.309%	
Jordan #3	1/24	6,800,548.54	12/31/86	11.087%	
Jordan #4	1/24	519,683.00	3/15/88	11.063%	
Ecuador #2	1/24	574,638.81	8/25/84	11.360%	
Honduras #3	1/24	60,885.00	8/1/83	11.535%	
Israel #8	1/24	1,550,000.00	9/1/09	11.115%	
Spain #1	1/29	70,785.00	6/10/87	11.385%	
Turkey #4	1/31	102,168.00	6/3/91	11.329%	
Colombia #3	1/31	36,666.00	9/20/85	11.494%	
Egypt #1	1/31	3,258,148.00	9/1/09	11.363%	
Jordan #3	1/31	1,094,324.50	12/31/86	11.437%	
Jordan #4	1/31	3,365,170.00	3/15/88	11.410%	
FARMERS HOME ADMINISTRATION					
Certificate of Beneficial Ownership	1/31	595,000,000.00	1/31/85	11.295%	11.614% annually
GENERAL SERVICES ADMINISTRATION					
Series L-063	1/17	88,342.33	11/15/04	10.699%	
Series K-028	1/17	131,037.04	7/15/04	10.674%	
Series M-055	1/17	2,978,875.35	7/31/03	10.696%	
Series M-056	1/24	119,657.00	7/31/03	10.954%	
Series K-029	1/30	164,020.25	7/15/04	11.255%	
DEPARTMENT OF HEALTH, EDUCATION & WELFARE					
HMO Block #6	1/29	9,423,668.48	various	11.235%	
RURAL ELECTRIFICATION ADMINISTRATION					
Arkansas Electric #97	1/2	5,698,000.00	1/2/82	11.565%	11.402% quarterly
Tri-State Gen. & Trans. #89	1/2	4,327,000.00	12/31/86	10.535%	10.400% "
South Mississippi Elect. #3	1/3	125,000.00	1/7/82	11.515%	11.354% "
South Mississippi Elect. #90	1/3	431,000.00	1/7/82	11.515%	11.354% "
Tri-State Gen. & Trans. #89	1/3	7,785,000.00	11/30/86	10.685%	10.546% "
South Carolina Telephone #12	1/4	505,000.00	12/31/14	10.521%	10.386% "
Southern Illinois Power #38	1/4	100,000.00	1/4/83	10.965%	10.819% "
M & A Electric #111	1/9	200,000.00	1/9/82	11.435%	11.276% "

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
RURAL ELECTRIFICATION ADMINISTRATION (continued)					
Doniphan Telephone #14	1/10	$ 150,000.00	12/31/14	10.501%	10.367% quarterly
Wabash Valley Power #104	1/10	4,602,000.00	12/31/14	10.501%	10.367% "
Wolverine Electric #100	1/10	989,000.00	1/10/82	11.415%	11.257% "
Allegheny Electric #93	1/10	2,867,000.00	1/31/82	11.375%	11.218% "
Northern Michigan Elect. #101	1/10	1,263,000.00	1/10/83	10.855%	10.712% "
Colorado-Ute Electric #78	1/11	880,000.00	1/11/82	11.355%	11.198% "
Tri-State Gen. & Trans. #37	1/11	128,000.00	12/31/86	10.665%	10.526% "
South Texas Electric #109	1/14	2,000,000.00	1/14/82	11.505%	11.344% "
Arkansas Electric #97	1/14	10,000.00	1/14/82	11.505%	11.344% "
East Kentucky Power #73	1/15	8,746,000.00	1/15/82	11.525%	11.364% "
Western Illinois Power #99	1/15	4,859,000.00	1/15/82	11.525%	11.364% "
Central Iowa Power #51	1/17	942,000.00	12/31/14	10.618%	10.481% "
Associated Electric #132	1/18	19,400,000.00	1/18/82	11.545%	11.383% "
Seminole Electric #141	1/18	12,732,000.00	1/18/83	10.945%	10.799% "
Cajun Electric Power #76	1/22	50,000,000.00	1/22/83	11.125%	10.974% "
Dairyland Power #54	1/22	1,400,000.00	1/22/82	11.755%	11.587% "
Big Rivers Elect. #58	1/23	521,000.00	1/23/82	11.735%	11.568% "
Big Rivers Elect. #91	1/23	2,846,000.00	1/23/82	11.735%	11.568% "
Big Rivers Elect. #136	1/23	67,000.00	1/23/82	11.735%	11.568% "
Brazos Electric Power #144	1/24	2,810,000.00	1/24/82	11.705%	11.539% "
Westco Telephone #112	1/30	1,000,000.00	1/30/82	12.055%	11.879% "
Hoosier Energy #107	1/30	30,000,000.00	1/30/83	11.435%	11.276% "
Corn Belt Power #94	1/31	300,000.00	1/31/82	12.015%	11.840% "
East Kentucky Power #140	1/31	3,666,000.00	1/31/82	12.015%	11.840% "
Basin Electric Power #87	1/31	350,000.00	1/31/82	12.015%	11.840% "
Basin Electric Power #87	1/31	10,195,000.00	1/31/82	12.015%	11.840% "
Basin Electric Power #137	1/31	35,000,000.00	1/31/82	12.015%	11.840% "
SMALL BUSINESS INVESTMENT COMPANIES					
C & C Capital Corp.	1/23	500,000.00	1/1/83	11.135%	
Rice Investment Co.	1/23	200,000.00	1/1/83	11.135%	
Sprout Capital Corp.	1/23	2,000,000.00	1/1/83	11.135%	
Rice Investment Co.	1/23	200,000.00	1/1/85	11.035%	
Rice Investment Co.	1/23	200,000.00	1/1/87	11.085%	
First SBIC of Alabama	1/23	500,000.00	1/1/90	11.035%	
Gold Coast Capital Corp.	1/23	400,000.00	1/1/90	11.035%	
Intercapco, Inc.	1/23	750,000.00	1/1/90	11.035%	
STUDENT LOAN MARKETING ASSOCIATION					
Note #229	1/2	1,520,000,000.00	1/8/80	12.821%	
Note #230	1/8	1,520,000,000.00	1/15/80	12.645%	
Note #231	1/15	1,535,000,000.00	1/22/80	12.603%	
Note #232	1/22	1,580,000,000.00	1/29/80	12.911%	
Note #233	1/29	1,595,000,000.00	2/5/80	12.748%	
TENNESSEE VALLEY AUTHORITY					
Note #120	1/9	25,000,000.00	4/30/80	12.697%	
Note #121	1/15	10,000,000.00	4/30/80	12.573%	
Note #122	1/23	35,000,000.00	4/30/80	12.844%	
Note #122-A	1/30	15,000,000.00	4/30/80	12.804%	
Note #123	1/31	515,000,000.00	4/30/80	12.815%	
Power Bond 1980, Series A	1/31	500,000,000.00	1/31/05	11.225%	
Seven States Energy Corporation					
Note #4	1/31	526,236,242.60	4/30/80	12.815%	

FEDERAL FINANCING BANK

January 1980 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
DEPARTMENT OF TRANSPORTATION					
Section 511					
Chicago & North Western 511-78-2	1/14	$ 290,552.00	5/1/86	10.817%	11.110% annually
Chicago, Rock Island	1/17	1,778,898.00	12/10/93	10.859%	11.154% "
Chicago & North Western 511-78-3	1/17	1,254,765.00	11/1/90	10.831%	
Chocago, Rock Island	1/18	914,697.00	12/10/93	10.913%	11.211% annually
Missouri-Kansas-Texas RR	1/22	500,000.00	11/15/96	11.124%	10.973% quarterly
Emergency Rail Services Act					
Milwaukee Road	1/7	5,000,000.00	7/3/80	13.085%	
Milwaukee Road	1/18	16,025,833.00	7/3/80	12.815%	
United States Railway Association					
Note #19	1/9	1,000,000.00	12/26/90	10.735%	
Note #17	1/18	4,017,500.00	4/29/80	12.556%	
WESTERN UNION SPACE COMMUNICATIONS, INC.					
	1/2	700,000.00	10/1/89	10.602%	10.883% annually
	1/21	6,650,000.00	10/1/89	11.587%	11.755% "
	1/24	1,610,000.00	10/1/89	11.016%	11.319% "

epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE March 4, 1980

RESULTS OF TREASURY'S 43-DAY BILL AUCTION

Tenders for $4,002 million of 43-day Treasury bills to be issued on March 5, 1980, and to mature April 17, 1980, were accepted at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	98.185	15.195%	15.69%
Low -	98.163	15.380%	15.88%
Average -	98.173	15.296%	15.80%

Tenders at the low price were allotted 99%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

Location	Received	Accepted
Boston	$ 30,000,000	$ 10,000,000
New York	8,119,000,000	3,436,750,000
Philadelphia	---	---
Cleveland	---	---
Richmond	125,000,000	125,000,000
Atlanta	---	---
Chicago	635,000,000	180,000,000
St. Louis	55,000,000	20,000,000
Minneapolis	20,000,000	20,000,000
Kansas City	10,000,000	10,000,000
Dallas	---	---
San Francisco	570,000,000	200,000,000
TOTAL	$9,564,000,000	$4,001,750,000

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

FOR IMMEDIATE RELEASE
March 5, 1980

Contact: Robert E. Nipp
202/566-5328

THOMAS B.C. LEDDY
APPOINTED DEPUTY ASSISTANT SECRETARY FOR
INTERNATIONAL MONETARY AFFAIRS

Secretary of the Treasury G. William Miller has appointed Thomas B.C. Leddy, 37, as Deputy Assistant Secretary of the Treasury for International Monetary Affairs in the Office of the Assistant Secretary for International Affairs. Mr. Leddy succeeds F. Lisle Widman, who has retired after more than 40 years of government service.

In his new capacity, Mr. Leddy will play a key role in developing and implementing U.S. international monetary policies and will be particularly concerned with U.S. economic and financial relationships with other industrial countries.

A career employee, Mr. Leddy began his government service in 1965 as an international economist in the Office of the Assistant Secretary for International Affairs (OASIA). From 1968 to 1970, he served as Assistant Financial Attache in Tokyo, Japan. Since returning to the United States, Mr. Leddy has served in a number of positions in the Treasury Department. From 1970 to 1973 he was an International Economist in the Industrial Nations Finance unit of the International Monetary Office; from 1973 to 1977, he was Deputy Director, Office of International Monetary Affairs, and 1975 to 1979, U.S. Alternate Executive Director, International Monetary Fund. From 1977 to 1979, he also served as Special Assistant to the Under Secretary of the Treasury for Monetary Affairs. In 1979, he was appointed Director of the Office of International Affairs, where he has served until this appointment.

Mr. Leddy received a Bachelor of Arts degree in Economics from George Washington University in 1964, and has completed course work toward a PhD from that University.

A native of Washington, D.C., he is married to the former Eileen Bullock of Virginia. They have two daughters and live in Vienna, Virginia.

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epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

Remarks of F. Lisle Widman
Deputy Assistant Secretary of the
Treasury of the United States of America*

before the "Australia 2000" Seminar
sponsored by the Stock Exchange of Melbourne

Melbourne, Australia

February 28, 1980

THE CHALLENGE OF GLOBAL INTERDEPENDENCE

It is a great honor to follow to this podium your esteemed Prime Minister. In keeping with your theme -- Australia 2000 -- he has focused our attention on many of the opportunities of the far horizon. The turn of the century is only 20 years away, but if the next 20 years change at the pace which has characterized the last two decades -- and the probability is that this will happen -- it will place us in a very different world from the one we see today.

Last year the Organization for Economic Cooperation and Development published the results of a three-year research project titled "Facing the Futures: Mastering the Probable and Managing the Unpredictable." The report concluded that there are no inherent physical limits on world wide economic growth for the next half century -- provided nations achieve profound structural changes in the areas of energy relations, agriculture, raw materials, climate and protection against toxic products -- a not inconsiderable agenda!

This "Interfutures" report, as it is called, emphasizes that the key to the achievement of mankind's material objectives in the years ahead is international cooperation to improve the functioning of international markets and to reduce the vulnerability of national economies. The report suggests that the achievement of these aims will necessitate the development and strengthening of institutional arrangements and a readiness by governments to take account in their own decisions of the impact of their domestic policies on others.

*Retiring

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The OECD report concludes that "management of the world's interdependence will be the result of a long learning process, and the pragmatic, but active, pursuit of this process is essential." Today I hope to touch a bit more specifically on the problems of living in a world of increased economic interdependence and to suggest some elements of a strategy for coping with the challenges that stretch out before us to the year 2000.

The peoples of the world want independence -- we are seeing political fragmentation even in some of the most advanced nations. Yet the dramatic advances in the technology of communications and transportation have helped to make nations more mutually dependent -- both economically and politically.

Since 1949 the volume of trade across national boundaries has grown about seven percent per year while total world output expanded by something less than five percent per year. Even in the U.S., long the prime insular continental economy, the ratio of exports and imports to GNP has doubled over the last 30 years, going from 7.6 percent to 15.4 percent.

The international flow of capital has increased even more dramatically -- partly because of the expansion of individual firms which carried their technology and managerial skills to all parts of the world. The development of international banking and the growth of world money markets has substantially integrated most major domestic financial markets into the international financial system. Finally, we have all become supremely conscious of international dependence on a relative handful of energy suppliers.

There is, of course, nothing historically unique about product specialization and trade among mutually dependent countries such as I have described. What has changed, I think, is the degree of these economic interrelationships.

Why has this happened? Fundamentally because the world wanted the higher standards of living that specialization made possible. We enjoy higher consumption and growth possibilities when countries specialize according to their comparative advantage. Growth rates in capital-short countries rise, and savers in countries with saving surpluses reap higher rewards, when capital flows to countries with profitable investment opportunities they could not undertake on their own. If we tried to produce everything at home and refused to let investment capital flow internationally, our countries could not have a standard of living remotely comparable to that we now enjoy.

Postwar governmental policies have on the whole facilitated growing specialization and interdependence. There has been a gradual and significant reduction in barriers to non-agricultural trade. A relatively free, multilateral world payments system was erected, beginning with Bretton Woods and evolving over the years into the present more freely flexible exchange rate system.

Of course, there have been disappointments. The Soviet Union has never fully participated in this system. From time to time, individual countries have tried to insulate their economies from the world economy. Failures in domestic policy have sometimes led to the erection of trade barriers in hopes of deflecting external pressures. But we have generally found that attempts to prevent freer trade and payments have proved costly, perhaps even more to the countries imposing restrictions than to their trading partners. By and large, over the last 20 years the movement has been toward a more free and interdependent global economic system. Few indeed would want to return to autarky and the lower standard of living it implies.

A STRATEGY FOR PROGRESS

Economic interdependence has gone so far, and employment and income patterns for nearly the entire world are now so structured around this interdependence, that a retreat would seriously disrupt the world economy both economically and politically. All nations would suffer. Thus we all have a major stake in the preservation of the open trade and payments system within which most of the world functions today.

The pressures of political nationalism and the lobbying of special interest groups gnaw away at the open system almost constantly. Nearly every country finds it necessary to concede a little from time to time to some particular protectionist group. But if there are too many backward steps on that slippery slope and the overall impression is one of backsliding, the risks of emulation, of retaliatory restrictions, of turning inward, can mushroom quickly. It is of great importance that the periodic setbacks in particular situations be offset by continued liberalization in other areas. The overall thrust must be toward further interdependence.

Our task is to maintain that forward thrust within the framework of our independent political units. How the world political system will have evolved by the year 2000, I certainly cannot say. But working with the mix of systems and goals we have known in the non-communist world in the post war era, and assuming that political change in most countries will be gradual and orderly, I can at least suggest some elements of a strategy for an approach to the year 2000.

In outlining such a strategy I offer nothing that is dramatically new -- we have known for some time the requirements for successful cooperation. But this knowledge does not imply general acceptance of the tasks, nor does it mean that it is easy to follow. The strategy is complex, incorporating elements from a number of policy areas:

- -- the energy constraint;
- -- the distribution of world income;
- -- the basic terms and conditions of international trade and investment;
- -- last but not least, the monetary system: the international impact of national policies for growth, employment and price stability, the operation of money and capital markets, exchange rates and the roles of various types of assets in financing international imbalances.

<u>Energy</u>

Energy is the most imminent of the challenges we face. In the United States we talk about having become excessively dependent on imported oil -- about 47 percent of our requirements. We have concluded that we must reduce that dependence. In theory there is no reason that the United States could not rely on imports for virtually all of its oil requirements. Japan does. So does Germany. (Australia is in the enviable position of producing about 70 percent of its oil requirements.) In reality, however, we cannot allow the world's largest economy to be hostage to either political or economic events in a small group of states, particularly as that would reflect major deterioration from the existing situation. With the prospect of continued increased global demand for oil; with supply heavily concentrated in a number of countries which have no

immediate need to sell the desired volume of oil; with some producing areas experiencing political uncertainties; with oil producers concerned about the depletable nature of their resources; and with the long-term prospect of a substantially rising price in terms of consuming country purchasing power -- the whole world finds itself in a very unstable and unsatisfactory energy situation.

The oil situation is a case of one sided "interdependence." Oil importers have developed their economies on the basis of readily available oil supplies. But the rather under developed economies of many oil producers are not as dependent on imports. Their stake in the health of the world economy is far less than that of the oil importers. The structural change in the world's balance of supply and demand for oil has come too suddenly, with too much impact on the cultures, the religious traditions and the political structures of some of the oil exporting nations. It has come much too suddenly for the importing states as well. As long as energy prices remained relatively low, entire economies were structured around the relatively low cost of petroleum. The line between surplus and shortage is slim, but the ratio of energy input to overall economic output is, in the short run, quite rigid.

The industrial world did not correctly anticipate the radical increase in the relative price of oil since 1972. Now it finds that the lead times for expansion of alternative energy sources are very, very long, and voter resistance to the life style changes which a significant change in the ratio of energy input to economic output will require is very great.

There is a lesson here: changes must be gradual -- even changes in the direction of additional interdependence. And it is dangerous to be completely dependent on suppliers who in some cases are independent of their customers, or who may have political systems of questionable durability.

For the next year or two, with the U.S. anticipating a shallow recession followed by slow recovery, and growth rates sliding off to low levels in much of the industrialized world, the supply of oil should be adequate unless political events disrupt the flow. But as one looks just beyond this period, to the time when global output should be rising more rapidly, oil producers may simply not be prepared to produce the volume of oil required which would be needed to achieve that growth -- not at any price. In fact, the producers may not even have the capability to meet such a demand. It is questionable whether investment programs begun even today could create that capacity in time.

If energy is in short supply, the price will go up. It will climb until the demand slackens. And if too little has been done to improve the efficiency of energy use -- reduce the amount of energy input required per unit of output -- there simply won't be the increased output nations want. But there will be a great deal more inflation than they want. It isn't very easy in our democratic societies to keep increases in the oil price from spilling over into higher wages and higher prices of everything else.

If the world wants to move in triumph toward the year 2000, it must act on the energy crisis today. We must search out more of the world's oil and produce it. But develop other types of energy as well. The real cost of oil is rising so rapidly that we must move forward with coal, natural gas, coal gasification and liquifaction, with development of tar sands and oil shales, nuclear power and the various synthetics and revewable forms of energy.

We need to set in motion all of the research and development efforts we can mobilize to ease what will otherwise be a severe restraint on the world's economic progress in the 80s, the 90s, and even the year 2000.

And in the meantime we must do everything possible to increase the efficiency with which the world uses the energy it has.

Distribution of World Income

The revolution in communication and transportation has made people of the less developed nations acutely aware of the material goods available to most residents of the industrial nations. Not surprisingly, that awareness has created dissatisfaction with existing political and economic systems.

The industrial nations have sought to ease this problem by promoting rapid economic growth throughout the world -- reasoning that increased total output would bring more to the poor with no less to the rich. A small share of a larger pie may be greater than a larger share of a small pie.

Private sector trade and foreign investment has made a major contribution to LDC growth. The industrial nations of the world will be providing something like $15 billion in grants -- outright resource transfers -- to the developing world in 1980. Many billions will be provided in the form of credits with some concessional element. Major strides are being made, largely through multilateral institutions, but also bilaterally, to assist the developing nations in the utilization of their own savings and their own resources.

The results of this effort have been greater than generally realized. Output has been increasing faster in the developing world as a whole than in the industrial world. LDC growth has averaged 5.5 percent a year over the last 10 years, compared to an average of 3.5 percent in the industrial world. Several important developing nations are well along toward what some now call "newly industrialized" status. In some areas -- the rim of East Asia, for instance -- growth has averaged an impressive 9.3 percent for a decade.

Other countries have, unfortunately, not shared in this progress. In some cases the bulk of the increased output is being devoured by increased mouths. And even where growth has been rapid, there has not always been political stability. Witness what has happened in Iran.

Consequently the developing countries are seeking a "new" international economic order. They advocate massive increases in resource transfers by any and every means that anyone suggests -- new price agreements on commodities, more concessional aid, control of international financial institutions by the LDCs while the industrial nations continue to provide the funds, money creation and distribution to the developing nations, etc.

Efforts to equalize incomes simply by massive increases in transfer payments from wealthy countries to poor ones are not likely to produce much sustained growth in poorer nations. The approach is politically unrealistic, and the more strained the world economy the less realistic it becomes. Industrial nations are encountering enough voter resistance to higher taxes for transfers within their own societies. Transfer of the control of the multilateral development banks or of the International Monetary Fund to the developing nations would simply dry up the industrial country financial support for these institutions essential to their operation.

The developing nations could do most to promote their own growth by creating a climate which would make it attractive for investors to come into these areas with technology and capital, and thereby enable the developing countries to employ their people where they have a distinct comparative advantage.

The industrial nations should also do more to assure access to their domestic markets for LDC manufactured goods. The United States has made respectable strides in this direction. Our imports of manufactured goods from non-OPEC developing countries nearly tripled between 1973 and 1978, from $7.3 billion to almost $21 billion.

To be sustainable the process must be gradual, so as to ease the impact of structural adjustment on the industrial world. This may be one of the most important avenues for increasing economic interdependence over the next 20 years. It requires difficult political choices and major changes in the structure of employment in the industrial world, but if the industrial nations accommodate the change rather than resist it, they themselves will reap great economic benefit, both directly and through improvement in the atmosphere of cooperation with the Third World. The Organization for Economic Cooperation and Development is embarking on a major effort to obtain support for this "positive" adjustment. That effort will need to be pursued for a good many years to come.

Progress may also be possible in helping to dampen price movements for specific commodities whose demand is highly responsive to changes in the levels of economic activity in industrial nations. By this means the inflation-deflation shocks of one-commodity countries might be significantly eased. And over time the terms of trade can be expected to shift toward raw material producing countries, including LDCs.

Except to the extent success can be achieved by cooperative efforts of this nature, the developing nations which are heavily dependent on imported oil will, sooner or later, have to slow their development in order to pay the increased real cost of that oil. There is no practical alternative. That pressure will come as their debt burdens rise and credit institutions raise the yellow flag of caution.

International Trade and Investment

The nations of the world have just completed major trade negotiations in which they have agreed on substantial tariff reductions phased over an eight-year period and new codes regulating government intervention in non-tariff areas (including subsidies, government procurement, standards, and licensing). The MTN agreements, however disappointing they were in the agricultural area, are a major achievement in continuing progress toward a more open world economy despite difficult economic circumstances in most countries.

The next steps must lie in avoiding protectionist back-sliding and in implementing, interpreting, and building upon the new non-tariff codes and dispute resolution mechanisms which will form the basic framework for trade relations in the decades ahead. Improvements in the present international understanding on official export credits are also essential to avoid excessive and disruptive competition in this area.

We also need to address the increasingly important problems in the field of international investment, and gradually evolve an international body of regulations in this area similar to the GATT for trade and the IMF regulations in the monetary area. More than ever before, investment is becoming the engine of future economic growth and a key factor in future trade flows. When government intervention favors -- or hinders -- the location of industrial plants in particular countries, the economic benefits to the world as a whole are reduced and economic relations among countries may be adversely affected.

This is a very complex area of policy, and the obstacles to agreement are great. Yet if no agreements are worked out, we can expect competition among countries which results only in a waste of taxpayers' funds in fruitless efforts to advance each country's trade position at the expense of all others.

The Monetary System

If we are going to trade with one another and to operate wholesale money and credit markets on an international basis we have to have a monetary system -- a method of pricing, a vehicle for payment and a method of holding financial balances.

Xenocurrency Markets. We find ourselves in a period of extremely large imbalances in current payments for goods and services. A half dozen oil-producing countries had an aggregate surplus last year of something in the range of $60 billion. This year, given what has happened to the price of oil, those surpluses may be double that figure. By definition, the rest of the world must face deficits of an equivalent amount. Obviously the imbalances could not occur unless there were a mechanism for financing them. Equally obviously, the sudden elimination of these imbalances would spell economic disaster.

In the early post war years most countries were dependent for credit on loans from other governments and from the international financial institutions. Their deficits were limited by the availability of funds from these sources. The relaxation of barriers to private lending and the development of what has become virtually a global money and capital market opened up the possibilities for much larger imbalances in nations' current account positions.

Even though governmental and international institution lending has risen in amount, it has financed only about a quarter of the aggregate imbalances in recent years. The poorer countries are still limited in the deficits they can allow by the financing they can obtain from official sources, but the rest have more scope.

Most of this borrowing is in the Eurocurrency market -- or "xenocurrency" market, to use a more accurate albeit less recognized term. It flourishes because the absence of reserve requirements, freedom from certain taxes, and the economies of scale stemming from very large transactions give it a competitive edge in most cases over the national markets to which a borrower could go directly.

Concerns have been voiced that the xenocurrency market extends too much credit and thus exacerbates world inflation and that the participating banks may be lax in their application of standards of credit risk. Although there is some validity to these complaints, I believe the concerns are exaggerated. In any event, it seems unlikely that actions will be taken which deprive borrowers throughout the world of access to highly efficient, solidly based international credit markets.

The prudential aspect of the xenocurrency market is likely to be improved in the years ahead. The U.S. bank supervisory authorities already examine U.S. banks on a consolidated basis; the German and British authorities are moving in a similar direction. We should see further movement toward a situation in which all the branch, and possibly subsidiary, offices which operate in this xenocurrency market are subject to the same lending standards as are applied to their home offices. The entire system will benefit from this development.

In addition, the monetary authorities of the major countries are gaining insight into the relationship between domestic monetary policy and international credit flows. It has become more important that the volume of xenocurrency deposits be taken into account when central banks look at their domestic monetary aggregates and determine the need for injecting or withdrawing reserves from domestic banks.

Committees of central bankers are currently studying both the need for some form of additional supervision or control over the xenocurrency operations and how such supervision or control should be exercised if found to be needed. They are also working to develop better data on these operations.

With the return of extremely large OPEC surpluses, questions are also being raised as to whether the private markets will -- as they did in 1974 and 1975 -- "recycle" the surpluses, permitting countries to incur the current account deficits which now seem in prospect. Private lenders are likely to be more cautious this time in their lending to countries which appear to be approaching the limits of their creditworthiness. For countries which are good credit risks, however -- and I think both Australia and the United States fall in this category -- the availability of funds is not likely to be a problem. The oil exporting countries must invest their surpluses. They will lend directly to countries whose fundamental position is strong, but they will also no doubt continue to offer deposits to the xenocurrency banks, thereby providing those banks with ample funds for on-lending.

The fear is that countries will borrow too much, for too long a period of time, in a desperate effort to avoid a slowdown in development and a reduction in consumption. Unfortunately, there appears to be no alternative to adjusting domestic economies structurally to the higher real price of oil. If countries delay too long in initiating the necessary adjustments, they will erode their creditworthiness and find themselves forced into a very abrupt and severe retrenchment which may be politically destabilizing. Ideally, borrowing countries will recognize the need to adjust at an early stage. With the proper adjustment policies in place they are more likely to be able to obtain financing to cover their remaining needs.

The International Monetary Fund can play a crucial role in permitting countries to accomplish their adjustment gradually and with far less impact on their people than would otherwise be necessary. But it can do so only if the countries come to the Fund at an early stage and if they are prepared to institute the stabilization programs which are essential to the reduction of their deficits to levels which preserve their creditworthiness.

This is the direction in which the world must move to preserve the soundness of this vast credit system. If it does, we should continue to see the volume of international credit outstanding rise steadily as the years pass -- and still do so safely.

<u>Role of the Special Drawing Right</u>. Another trend which may have significance for the longer term is the gradual increase in the use of currencies other than the dollar -- for pricing, for invoicing, for investment and for the holding of liquid balances. It is not a dramatic shift and the pace ebbs and flows from time to time. Some fading of the dollar's role is probably inevitable as other economies come to play a relatively larger role in the world. The U.S. accepts this evolution as long as it occurs smoothly without disruption to the system.

The U.S. is determined to keep the U.S. dollar strong and stable but there is no dollar imperialism -- no interest in trying to compel the world to remain on a dollar standard. In any event, there simply is no realistic alternative to the the dollar today. Even Iran is discovering that.

But a full fledged multinational currency reserve system may not serve the world well. It may not be stable. There may be too great a likelihood of disruptive swings in liquid balances from one currency to another as changes occur in the policies and prospects of individual countries.

Four years ago, at Jamaica, the members of the Interim Committee of the International Monetary Fund agreed to work toward a system in which the Special Drawing Right would be the principal reserve asset in the system. The SDR is a "basket," a composite of the currencies of the 16 countries with the largest share in international trade. It should, therefore, offer better protection against exchange rate movements for a number of countries than any single national currency.

SDRs are created by the IMF. They are issued to governments and central banks and some international institutions. There are limits on holders and regulations on their transfer. But there is nothing to prevent the extension of credit by private lenders denominated in SDR, payable in any specified national currency or currencies. Some U.S. banks offer such credits. Demand for them is on the increase.

The IMF is now considering what is referred to as a "substitution account." Participants would deposit U.S. dollars with this account and receive a claim denominated in SDR. At this stage the idea is still an idea -- but the objective would be to foster the use of the SDR not only by central banks but also by the private market. This is a genuine year-2000 project, the kind of shift which must be expected to evolve over a period of many years.

I know that your authorities here in Australia have been skeptical. They question whether such an instrument can be made sufficiently attractive to be widely used without imposing too heavy risks on participating governments. At this stage we do not know. But given the uncertainties of the next 20 years and given trends, it certainly seems worth trying. It is one specific, practical step toward coping with economic interdependence.

Exchange Rate Stability. Finally, there remains the basic question of exchange rates. In the early postwar years the world operated on the assumption that fixed exchange rate relationships could be set and governments could maintain them by using reserves or by borrowing. The IMF was established to provide a basic set of rules for the international monetary system and to provide balance of payments financing.

Although the world economy flourished for a good many years under this system, it eventually broke down. Now the obligation of IMF members to maintain fixed rates of exchange for their currencies has been replaced by obligations to pursue domestic policies designed to achieve the underlying economic stability that is required to sustain stability of exchange rates. This change reflects a recognition that it is the basic performance of the domestic economies of the major countries which determines whether exchange rates will be stable.

Stability in exchange markets remains an objective. Close cooperation among central banks in their use of intervention is important, but not sufficient. If there is to be stability, it has to be founded on stability in the relationship of domestic prices, monetary conditions and rates of economic growth among nations. That requires the pursuit of a combination of basic fiscal and monetary policies in the individual countries which fosters stability.

How can the coordination of these basic policies, which are at the core of national sovereignty, be achieved? The world is far from accepting a central government which would have the power to set tax rates for every citizen and every corporation throughout the globe. And it is many years away from having a world central bank which sets the limits on the amount of money which banks can borrow. The power to tax, the decision to spend, the authority to control credit and thus influence interest rates -- these are powers which nations will guard very jealously for a long, long time. Each country wants to be sure that these decisions are made in strict accord with its own preferences.

This is the central problem with which we must wrestle as we proceed on the path of economic interdependence. I think there is a way to go forward -- to get increasing coordination which will promote stability, but without world government or other schemes of centralized world political authority. It offers no guarantees, no legal force -- but it should help.

This way -- this key -- is in the exchange of information, in the sharing of analysis, and in the development of consensus as to the combination of policies which at any one time are best suited to the promotion of stability. If governmental leaders can be convinced of the advantages of a mutually supportive set of policies and are prepared to return to their capitals to seek the adoption and implementation of those policies in accordance with the laws and customs of their land, we at least have a start in the direction of stability and economic health. Some may fail to convince their public or their legislatures. Some may win approval for the policy but fall flat in their implementation -- but at least the outcome should be more favorable than policies set without reference to what others may do and without any common vision.

How can this be achieved? Through a combination of formal and informal mechanisms. I submit that the IMF provides the best basis for a formal institutional mechanism to coordinate economic policies in an interdependent world. The IMF Articles of Agreement constitute the agreed operating rules of the international monetary system and establish member countries' obligations to promote a cooperative and stable world monetary order. Moreover, the Fund is the principal source of official balance of payments financing to help countries to adjust their payments positions in a manner supportive of national and international well-being.

The revised IMF Articles provide the Fund with enhanced authority and responsibility for surveillance over all members' exchange rate policies and the balance of payments adjustment process. The surveillance provisions increase the ability of the IMF to advise not only countries in balance of payments deficit, but also those in surplus, on the international implications of their policies and on the approaches they might appropriately follow to correct their payments imbalances.

In the period since the amended Articles took effect, the IMF has adopted new principles for the guidance of members in conducting exchange rate policy, and implemented procedures and criteria for assessing those policies. The guidelines, and IMF practice, reflect the new orientation of the Fund's exchange rate provisions that exchange rate stability can be achieved only by directing economic and financial policies toward fostering orderly economic growth with reasonable price stability. Consequently, the Fund's examination goes beyond narrowly defined exchange rate policy to encompass the broad range of economic policies affecting balance of payments adjustment.

The IMF has begun to implement surveillance in a cautious and prudent manner. Consultations under the new provisions have been held with virtually all IMF members, including both the U.S. and Australia.

The time has now come for the Fund to take bolder action. I believe it should:

-- Require any nation with an exceptionally large payments imbalance -- deficit or surplus -- to submit for Fund review an analysis showing how it proposes to deal with that imbalance;

-- Assess the performance of individual countries against an agreed global approach;

-- Advise on the financing of payments imbalances by surplus and deficit countries;

-- Give the IMF Managing Director a more active role in initiating consultations with members.

-- Establish a decision-making Governors Council to replace the advisory Interim Committee.

Progress in these areas would help achieve the closer coordination of economic policies required for a more stable global economy in the years ahead.

The formal mechanism of the IMF can also serve as the basis around which small informal groupings can be built. We all realize that when issues are controversial, and the matters very sensitive, small informal groupings may be crucial to success. There are such groupings now -- in the so-called economic "Summit" meetings of the heads of state or government of the seven largest nations, in the meetings of finance ministers and central bank governors of the five largest states and in the periodic gatherings of the IMF Interim Committee. Bilateral sessions are frequent -- Treasurer Howard met quietly with Secretary Miller at Belgrade last fall. Central bank governors of countries which participate in the work of the Bank for International Settlements confer monthly. Regular telephone conferences, using special equipment to provide security of transmission, now link both senior policy officials and foreign exchange traders of a number of central banks. These central bank communications are steps in the direction of promoting the coordination which fosters stability on the exchange markets.

Obviously much remains to be done. But the critical area lies in the difficulty of adopting domestic policies which can provide the domestic economic stabilization that is the key to stable exchange rates.

SUMMARY

In summary, economic interdependence has brought the world untold benefits, but the interdependence has reached a point which requires management on a global scale if it is not to produce distortions so severe as to imperil the retention of an open trade and payments system. Our task is to retain the benefits of interdependence without compromising on personal freedom and national sovereignty. To do so we must move forward on a variety of fronts. We must:

-- Urgently and drastically improve the efficiency with which we use energy.

-- Open further developed country markets to manufactured goods from the developing countries.

-- Seek greater stability of commodity prices.

-- Continue concessional aid.

-- Implement and expand upon the new nontariff codes.

-- Work to eliminate incentives which distort the allocation of investment resources.

-- Maintain sound media for international credit.

-- Encourage the use of the Special Drawing Right in international transactions.

-- Strengthen the role of the IMF in promoting international cooperation on the issues of basic macro economic policy.

-- Seek, through policies which maintain stability within nations and close cooperation among central banks, to maintain stability in foreign exchange markets.

With nations truly working together in these areas, the world should "master the probable and manage the unpredictable."

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

FOR IMMEDIATE RELEASE March 6, 1980

Treasury Secretary G. William Miller Presents
Congressional Gold Medal to Family of John Wayne

At a ceremony in the United States Capitol today, Treasury Secretary G. William Miller presented to the family of the late John Wayne a special Congressional gold medal in recognition of Mr. Wayne's distinguished career as an actor and his service to the Nation.

On the obverse of the medal is a head and shoulder portrait of Mr. Wayne with the inscription, JOHN WAYNE - AMERICAN. Mr. Frank Gasparro, Chief Sculptor and Engraver of the United States Mint, executed the likeness from a photograph furnished by the Wayne family. This photograph was Wayne's favorite portrait of himself, taken during the filming of "The Alamo."

Typifying the American Cowboy, the reverse of the medal, also designed by Mr. Gasparro, depicts John Wayne galloping on horseback in the rugged Western beauty of Monument Valley - location for many of his pictures and a familiar scene the world over.

Public Law 95-16 which authorized this national expression of appreciation, was signed on John Wayne's birthday, May 26, 1979. Provisions of the legislation permit the striking of bronze replicas by the United States Mint.

M-362

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REMARKS BY THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE
FUTURES INDUSTRY ASSOCIATION
MIAMI, FLORIDA
March 7, 1980

"Futures Markets--The Treasury Perspective"

I appreciate the opportunity to meet with the members of this important association to offer a few observations on recent developments in the futures markets. During the last several months, trading activity in all securities markets, and especially in financial futures, has reached all-time highs. The highest interest rates in our lifetimes have produced disorderly conditions in the bond markets and extraordinary strains on participants in the financial futures markets. These developments have placed a heavy burden on all markets and on the Commodity Futures Trading Commission (CFTC) and its statutory responsibilities for regulation of the futures markets.

Development of Financial Futures Markets

The financial futures markets have had phenomenal growth and tremendous success since their inception four years ago. The growth of trading in futures contracts based on Treasury securities has far exceeded expectations when such trading commenced in January 1976. Transactions in Treasury bill futures contracts alone totalled nearly 2 million contracts in 1979, representing some $2 trillion in annual trading volume, a twenty-fold increase in three years. The dollar amount of trading in the Treasury bill futures market now actually exceeds the total volume of dealer trading in the cash market for Treasury bills.

While trading volume in Treasury bill futures was soaring in 1979--and this growth has continued in 1980--there has been a remarkable reversal in the growth of open positions in these contracts. Open interest grew, along with trading volume, from $3 billion at the end of December 1976 to $17 billion at the end of 1977 and $59 billion at the end of 1978. But by the end of 1979 open interest in T-bill contracts had declined to $36 billion, and this decline has continued in 1980 to the current level of $25 billion. Such increases in trading volume coupled with declines in open interest presumably reflect increased day trading in response to recent increases in the level and volatility of interest rates. The T-bill futures market appears to have become a major vehicle for short-term speculation in interest rate movements.

You may well ask whether the Treasury reaction to this extraordinary growth in financial futures should not be approbation if not applause. Many useful functions can be served by financial futures. Positions can be hedged, risks transferred, transactions and research costs reduced in carrying out forward type commitments, and better information produced and disseminated.

Individuals and institutions who must hold inventories can protect themselves from adverse price movements by transferring risk to those who have a preference for risk bearing. This can be particularly important in periods such as those of the last ten weeks. Even though these activities also take place in cash markets and in unorganized forward markets, futures markets permit these activities to be carried out more efficiently. The existence of a central futures market (the exchange) facilitates bringing hedgers and speculators together. The fact that the exchange interposes itself, acting as guarantor of every contract, reduces the risk to each side. Furthermore, information on expectations becomes widely available as speculators and hedgers express their views through the prices they bid and offer. The fact that financial futures have grown as rapidly as they have suggests some economic purpose is being served.

These are valuable services. And it was not entirely predictable that a phenomenon so large and dramatic as the growth of the futures market should have produced such benefits with so relatively few apparent problems. However, neither the Treasury nor anyone else knows the full clinical anatomy of this new business of financial futures, and explosive growth typically brings with it unexpected side effects and problems. The number of new exchanges entering the financial futures industry creates even greater uncertainties, for it calls into question the viability of exchange self-regulation as each exchange seeks to promote new products and the increased use of existing contracts. Proliferation and the potential for the competitive devaluation of exchange self-regulation present new questions and new challenges. There are significant gaps in our knowledge about who is participating in these markets, what they are doing or why, and the extent of the economic purpose actually being served. Theories provide some guidance, but market practitioners provide conflicting opinions. While the Treasury has more than a century of institutional experience in the cash markets for its securities, it shares with you who operate the markets only four years of actual participation in financial futures. But as the primary issuer of the underlying securities, Treasury necessarily has a role to play.

Treasury Role

Let me comment briefly on the interests and responsibilities of the Treasury Department in the financial futures area. The Futures Act of 1978 (P.L. 95-405, September 30, 1978) provides that the Commodity Futures Trading Commission shall maintain communication with the Department of the Treasury, the Board of Governors of the Federal Reserve System, and the Securities and Exchange Commission for the purpose of keeping such agencies fully informed of Commission activities that relate to the responsibilities of those agencies. The Act further provides that the Commission shall solicit the views of the Department of the Treasury and the Board of Governors of the Federal Reserve System when a board of trade applies for designation as a contract market involving transactions for future delivery of any security issued or guaranteed by the United States or any agency thereof. The CFTC is required by the Act to take into consideration all comments it receives and to consider the effect that any such contract designation, suspension, revocation, or emergency action may have on the debt financing requirements of the United States Government and on the continued efficiency and integrity of the underlying market for government securities.

In keeping with these responsibilities the Treasury and the Federal Reserve Board conducted a study of the Treasury futures market, which included extensive interviews with market participants and consultations with the CFTC. The results of that joint study were published in May 1979.

As we indicated in the Treasury/Federal Reserve Study, the Treasury is primarily concerned with the potential impact of financial futures on the Treasury's debt management flexibility and on the underlying cash market in government securities. Surely, there can be no disagreement on this point -- that the overriding purpose of the Government securities market is to provide for the financing of the public debt at the lowest possible cost to the taxpayer. Moreover, since the Treasury securities market provides a benchmark for interest rates throughout the economy, the continued stability, efficiency, and integrity of the Government securities markets are essential not only to the efficient management of the public debt, but also to the Nation's economic health, and to the effective functioning of all financial markets.

From my vantage point, the joint study provides the first systematic--although necessarily incomplete--analysis of this market and how it is operating. The study focussed on the following areas:

1. The impact of futures trading on the efficiency and integrity of the cash market;
2. The adequacy of deliverable supplies and the possible constraints on debt management flexibility;
3. The ability of the exchanges and the CFTC to maintain effective surveillance, particularly in cases of duplicative contracts; and
4. The dangers for unsophisticated investors who may not fully appreciate the risks inherent in futures contracts when those contracts are based on USG securities.

As part of the study we sought the opinions of those who were favorable to futures markets and those who were unfavorable. Those who were favorable--generally the majority--argued that there were important social benefits from these markets, and these benefits are discussed at length in the study. But I must admit that another and perhaps the principal objective was to identify potential problems, and to determine how futures may affect the basic cash market for Treasury securities and the efficiency with which the cash market can accommodate the requirements of financing the public debt.

We recommended that the CFTC consider both the width of the maturity range of deliverable securities and the number of outstanding issues in determining the adequacy of deliverable supply. We recommended that the CFTC not approve a contract which depends solely on the deliverable supply of a single security yet to be issued and not designate new contracts which duplicate contracts on other exchanges. We also encouraged the CFTC to proceed gradually in authorizing new contracts, so as to minimize any perverse effects of rapid growth. These recommendations have been generally adopted by the Commission except that the Commission did not feel it could adopt our recommendation to proceed gradually in authorizing new contracts. The study also urged that investor safeguards be adopted, including customer suitability and the use of serial tapes by the exchanges, and much remains to be done in this area.

Since our study, we have learned considerably more about financial futures. Some concerns have been assuaged by experience and continued analysis. But other concerns still linger and, indeed, are reinforced by the press of new developments and events. As we enter a new phase of development in these markets involving multiple exchanges, duplicative contracts, and contracts on new instruments such as stock indices, the problems and warning signs become more pronounced. While we support developments that promote the efficiency of financial markets, and we recognize the value of the competitive process in determining which contracts and exchanges survive, these occurrences place new and difficult burdens on the industry and the regulators.

[illegible] comme[illegible] [illegible]ome of these unresolved issues.

Proliferation

In the area of Treasury securities and other debt instruments, thirteen financial futures contracts are now being traded, and ten additional contracts are under review by the Commission. In addition, at least a dozen new contracts have been proposed for stock index futures, ranging from futures on broad indices to narrowly defined sectoral indices. While the Treasury has reviewed only one of these index contracts, the KCBT futures contract on the Value Line Average, many others have been approved by the exchanges and submitted to the CFTC.

This sudden surge in financial futures raises new questions of proliferation and duplicative contracts and adds to our concerns that exchange self-regulation could weaken as each exchange seeks to promote its product. Many of the newer contracts have not been successful. On some contracts trading is virtually nonexistent. Yet, the exchanges have not been required to justify continuation of these contracts. Moreover, if new markets in stock index futures gain broad acceptance, the limited surveillance capabilities of the CFTC and the exchanges will be under increasing pressure, particularly in view of the need to deal with extraordinary trading and market situations in a number of other commodities markets.

Deliverable Supplies

Another unresolved issue is the adequacy of deliverable supplies. The "deliverable supply" problem, and possible pressures on the Treasury to relieve or prevent a squeeze in the cash market, needs to be addressed anew in light of the recent experience with the Treasury bill contract. For the December 1979 Treasury bill contract on the IMM, deliveries reached the unprecedented level of $1 billion, which was about half of the total estimated supply of bills available for delivery. Such pressures on deliverable supplies were a concern to many market observers in both June and December because of abnormal price relationships among the underlying cash market bills. Specifically, the deliverable bill traded out of line with surrounding maturities.

These developments are difficult to quantify and assess, but they increase concern about the possibility of manipulative or fraudulent behavior as well as the likelihood of disruptive effects on the markets for U.S. Government securities.

Use of Futures Trading for Tax Purposes

-- The episode of the December Treasury bill also suggests that tax motives may play a significant part in the trading in these markets.

The strong interest in taking delivery of the December Treasury bills appears to be traceable in part to efforts by some participants to reduce tax liabilities.

Trading in the futures markets for tax purposes is nothing new, of course. The popularity of commodity straddles for this purpose was evident long ago. However, the extent to which the futures markets are being used for strictly tax purposes appears to be growing, as is the complexity and sophistication of schemes designed to produce a specified tax deferral or avoidance result.

These trends can only be of concern to us at the Treasury. The underlying straddles do not serve any apparent economic function and the alleged liquidity increase is illusory because tightly straddled trades do not provide any market liquidity in any real sense.

Moreover, these trends should be of concern to you, the industry leaders. An industry that allows its economic purposes to be undermined by the proliferation of tax avoidance schemes invites regulation and restrictions.

Market Practices

In the market practices area, we are concerned with the complexity of contracts, the nature of participants in the market -- the March 1979 survey by the CFTC indicates nearly half of the outstanding contracts are held by individuals and commodity pools -- and the possibility that these markets may be increasing risk exposure rather than reducing it, even by professional participants, such as banks and financial institutions.

We are also concerned with a number of related problems involving questionable market practices that have surfaced in the forward markets, particularly in the Ginnie Mae forward market. Recent press reports indicate that a number of lawsuits are being filed against securities firms alleging that they promoted unsuitable and illegal investments. Persistent problems in the GNMA forward markets have led to growing pressures for regulation. Currently, the Treasury, Federal Reserve, and the SEC are conducting a study of markets for GNMAs and other government-guaranteed securities to identify the scope and significance of problems. We plan to complete this study in April.

The authority to establish and adjust margins and the adequacy of investor protection safeguards and suitability standards need to be addressed, particularly since the exchanges have given every indication that they plan on attracting substantial participation by individual investors through new products involving stock index futures and the retailing of existing financial instrument futures. Foremost among our concerns is the likelihood that futures contract will be inappropriately merchandised to investors who do not fully understand these contracts.

We envision the possibility that certain financial futures could become, in these times of heightened speculative excesses, a popular means for the uninformed to place "bets" on the future without reducing risk or serving as a legitimate hedging instrument. The joint Fed/Treasury study on financial futures in 1979 called for "further study of investor protection." And the SEC Options Study recommended that the broker/dealer be required to "find that the customer is capable of evaluating the risks" of options trading. The Treasury favors a more explicit and elaborate risk disclosure statement than that now required by CFTC's Rule 1.55.

In the broadest perspective, Treasury's interest is in the stability of the nation's economy and financial markets. History tells us that inflation begets speculation as investors strive to protect vanishing principal, and there appears to be a substantial speculative element in the commodities futures and financial futures markets today. Speculation, in turn, may increase the risk of sharp swings in the market that can victimize the investing public, discredit the market itself, and distort and impair capital formation in the process.

Accordingly, we favor a reevaluation of the margin question. At present, apparently neither the CFTC nor any other agency has clear authority to establish and adjust margins for approved contracts and thus could not stop ambitious futures exchanges from setting initial margins very low or even at zero (while still requiring daily, after the fact, marking-to-market). At a minimum, regulatory authority in this area should be specifically clarified. Obviously, there must be coordination among the CFTC, SEC, and Federal Reserve to monitor competitive inequities as between stocks, stock options, and stock futures.

I do not intend to prejudge the results of the ongoing Treasury/Fed/SEC study of the government-guaranteed securities markets but I think it is fair to say that the trends I have discussed must be addressed if this new industry is to continue its impressive growth and contribute to the nation's economic growth. That will require a joint effort between you who are the leaders of the industry and those--like the Treasury--with responsibilities to protect the public interest.

I am mindful that automatic nay-saying or knee-jerk recalcitrance on the part of governmental and regulatory authorities is not very useful. It is possible for an entity like Treasury that is properly concerned about excessive volatility in financial markets to fall into a "Chicken Little Syndrome," claiming perennially, "The sky is falling, the sky is falling." I can assure you our views will be balanced. But there are problems present here, and I hope we can all work constructively together to resolve them with the least cost and government involvement possible.

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STATEMENT BY
THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE
MARCH 10, 1980

Mr. Chairman:

Thank you for the opportunity to appear before the Committee in support of S.2271, legislation to strengthen the International Monetary Fund and to provide for maintenance of the U.S. role as the leader of this important institution.

We meet at a time of heightened international tension, affecting vital U.S. strategic and economic interests. Recent events have driven home dramatically the close interrelationship between foreign policy and economics. The turmoil in Southwest Asia has contributed to oil supply shortages and uncertainties and placed added strains on the international financial system. These developments have come at a time when the world economy is already facing extremely difficult problems. The massive oil price increases of the past year have led not only to slower growth and surging inflation but also to another period of dramatic changes in the balance of payments positions of the oil importing countries. And today's world economic environment is likely to make it both more difficult for nations to obtain the financing needed to deal with their balance of payments problems, and more difficult for them to make the necessary adjustments to changed external circumstances.

The success of our efforts to deal with political tension and maintain peace in the 1980's will depend importantly on our ability to address current economic problems. The IMF is a cornerstone of U.S. international economic policy, providing the institutional framework for world monetary cooperation, finance and trade that is vital to the economic prosperity of the U.S. and the global economy. A strong and effective IMF is essential to our efforts to assure world monetary and financial stability and to provide the broad cooperative framework we will need to overcome fundamental economic difficulties.

The IMF serves two related functions -- general guidance of the monetary system and provision of temporary financing in support of members' efforts to overcome their balance of payments problems.

First, the IMF's Articles of Agreement constitute the operating rules of the international monetary system and establish member countries' obligations to promote a cooperative and stable world monetary order. The decade of the seventies brought major changes in the international monetary system and in the IMF's role in guiding the system's operations.

In the area of balance of payments adjustment, the Bretton Woods par value exchange rate obligations have been replaced by obligations on members to pursue policies to achieve the underlying economic stability that is needed for genuine and sustained exchange rate stability. The IMF has been given the task of surveillance over members' compliance with those obligations, and over the operations of the balance of payments adjustment process more generally.

In the area of international liquidity the IMF membership has established the objective of making the Special Drawing Right (SDR) the principal reserve asset in the international monetary system to help avoid the instabilities inherent in a system based on a multiplicity of national currencies.

These changes have paralleled and to a large extent reflected changes in the position and role of the dollar in the system. The original Bretton Woods arrangements assumed a fixed and central role for the dollar, with the U.S. position essentially passive and the product of other countries' actions in pursuing their own balance of payments policies and objectives. That arrangement ultimately became both unsustainable and intolerable in terms of U.S. economic interests. The new arrangements have provided much more scope for balance of payments adjustment by the United States, and recognize the need for greater symmetry in encouraging adjustment by all nations -- those in surplus as well as those in deficit.

At the same time, the world's reserve system has been undergoing significant change. Increases in the relative economic size and financial capacity of other major countries have tended to bring some growing use of their currencies in international transactions and reserves. On the one hand, such a development could help to mitigate some of the burdens on the dollar and U.S. financial markets that arose from its extremely large international role. On the other hand, the process of change can itself be unsettling and disruptive, and there is a widespread view that increasing reliance on the SDR -- an internationally created and managed reserve instrument -- would be preferable to development of a full-scale multiple currency reserve system. The IMF over the past few years has taken a number of important steps to promote the role of the SDR and is presently considering a potentially significant further step in its examination of the substitution account.

The dollar nonetheless remains critically important to the operation of the international monetary system, and the U.S. economy remains a powerful element of that system. This will continue to be the case, and we recognize and accept the responsibilities incumbent on the United States to maintain a sound economic position and a stable dollar. At the same time, a strong IMF -- able to encourage effective economic and balance of payments adjustment by all countries and able to guide the orderly evolution of the reserve system -- is of direct and immediate importance to our economy and to our efforts to maintain the integrity and strength of the dollar.

The second basic function of the IMF, closely tied to its role in guiding the overall operation of the system, is the provision of temporary financing in support of members' efforts to deal with their balance of payments difficulties. Its aim is to encourage timely correction of balance of payments problems in a manner that is not distructive of national or international prosperity -- and thus to promote a smoothly-functioning world payments system in the context of a strong and stable international economy. This is a central objective of the IMF and one in which all members must participate as an obligation of IMF membership.

It is important to understand the nature of IMF financing. The IMF is essentially a revolving fund of currencies provided by every member and available to every member for temporary balance of payments financing under prescribed criteria. Each country is obligated to provide its currency to the IMF to finance drawings by other countries facing balance of payments needs; and each country in turn has a right to draw upon the IMF in case of balance of payments need. When a country provides financing to the IMF -- that is, when its currency is drawn from the Fund -- it receives an automatic and unchallengeable right to draw that amount from the IMF in usable foreign exchange. This is the so-called "reserve position" in the IMF, an automatically available reserve claim on the IMF which is normally carried in countries' international monetary reserves.

Financing thus flows back and forth through the IMF depending on balance of payments patterns and financing requirements at any given time. There is no set class or group of lenders or borrowers, no concept of "donor" or "recipient." All major industrial countries have drawn upon the IMF at times, and many members, developed and developing alike, have been both lenders and borrowers during the history of their participation in the IMF.

Proposed Increases in Quotas

Throughout its history, the IMF has needed periodic increases in its quotas in response to the rapid growth of world economic activity and international trade and financial transactions. To maintain a strong IMF, capable of encouraging needed adjustment while providing the temporary financing required to maintain monetary stability, we must assure that its resources are adequate to meet potential demands. The proposed 50 percent general increase in IMF quotas is a key element in assuring that strength.

Quotas play a central role in the IMF. Members' quota subscriptions constitute the IMF's permanent financial resources. Quotas determine both the amount of IMF resources a member can draw when in balance of payments need, and its obligation to provide resources when its balance of payments is strong. Quotas determine the distribution of SDR allocations. And, of key importance in all IMF operations, quotas also determine voting power. Unlike the case in many institutions, where member countries try to hold down their shares of participation, in the IMF countries compete to gain the largest possible share of the total because of the votes and financing that a larger quota share provides. The United States has by far the largest IMF quota and thus the largest share of votes and potential access to IMF resources.

To ensure that IMF quotas remain realistic and adequate, they are reviewed periodically in relation to the growth of international transactions, the size of payments imbalances and financing needs, and world economic prospects. Such a review was initiated in 1977 and led to a resolution adopted by the IMF Board of Governors on December 11, 1978, with the U.S. Governor concurring, calling for an increase in overall IMF quotas by 50 percent, raising total quotas from about SDR 39 billion to roughly SDR 58 billion. The increase proposed for the U.S. quota amounts to SDR 4,202.5 million, equivalent to about $5.4 billion at current exchange rates. This increase would raise the U.S. quota by 50 percent from SDR 8,405 million (or about $10.9 billion) to SDR 12,607.5 million (or about $16.3 billion).

The negotiation of quota shares is always difficult with pressures on the U.S. to accept a smaller quota share. Given the key roles of the dollar and the U.S. economy in the international monetary system, and the IMF's central role in guiding the operations and evolution of the system, it is essential that the U.S. maintain an appropriate share of quotas and votes, and thus its influence over basic decisions about the system. In the end, the pressures for a reduced U.S. share were successfully resisted during the most recent review, and only a very few selective changes in quota shares, all within the LDC group, were agreed.

The decision to propose a 50 percent overall increase in quotas reflected a widely felt view that quotas had, by any measure, failed to keep pace with potential balance of payments financing needs. Despite quota increases on four occasions during the IMF's history, aggregate quotas had fallen to about four percent of annual world imports in comparison with 8 to 12 percent during the 1960s and 10 to 14 percent during the 1950s. The adequacy of quotas had eroded particularly during the seventies, as the ratio of quotas to members' aggregate deficits fell by two-thirds between 1971-73 and 1978. In mid-1978 the Fund's usable quota resources -- that is, its holdings of the currencies of members then in strong payments positions -- totaled only about SDR 16 billion, or just over one percent of world imports. In November 1978, before the Supplementary Financing Facility was put in place, the amount of usable quota resources was effectively halved to around SDR 8 billion when the U.S. drew the equivalent of $3 billion and the dollar was taken off the IMF's "budget" of currencies used in financing current drawings.

These shifts in the IMF's "liquidity" illustrate the difficulties of projecting either the level of usable IMF resources or the level of future drawings on the Fund. In its 1977 quota review, the IMF estimated that the level of international transactions between 1978 and 1983 would increase by 60 percent in SDR terms. In fact, that 60 percent figure is now much too low, as inflation, oil price increases, and other factors have caused a much more rapid expansion in the value of world trade and financial transactions. And even if we could accurately predict future levels of world trade, we would not know the pattern of trade, the size and distribution of payments imbalances, or the availability of financing from banks and other sources.

In determining how large a quota increase would be needed, it was recognized that the IMF's Supplementary Financing Facility, introduced last year to provide badly needed resources to the IMF on a temporary basis, would be phased out after a 2-3 year period. That Facility was proposed and is regarded as a bridging operation to be followed by an increase in the IMF's permanent resources.

It was in the light of these considerations that the IMF membership concluded that a 50 percent increase in total quotas would be the minimum required to assure that the IMF remained in a strong position to meet prospective needs. Even a 50 percent increase will do little more than slow the decline in the relative size of IMF resources into the mid-1980's. In fact, most developing countries and some OECD members, fearing growing world economic uncertainties, pressed hard for a much larger increase.

Events since completion of the quota review have strengthened the justification for the quota increase. Oil market developments have again radically altered economic prospects and have drawn the world into a pattern of payments imbalances reminiscent of that following the 1973-74 oil price increase. Countries must, and will, begin adjusting to these developments, and that will cause further changes in world balance of payments patterns and financing needs that cannot be foreseen. Moreover, events in Iran and Afghanistan have created a climate of concern and uncertainty that makes it all the more important to have in place the institutional means for assuring monetary stability and for providing advice and financial support to countries facing the growing economic and financial problems of the 1980s.

At present, the IMF has usable quota resources estimated at about SDR 10 billion, plus SDRs held by the IMF totaling approximately SDR 1.1 billion. These resources are supplemented by amounts remaining available under the General Arrangements to Borrow equal to SDR 5.7 billion, and SDR 7.4 billion under the Supplementary Financing Facility which is scheduled to end in early 1981 or 1982.

Severe payments imbalances and consequent financing needs will very likely intensify during the next several years. At present, in broad terms, we anticipate an OPEC current account surplus of about $120 billion in 1980 and current account deficits, after official transfers, of about $70 and $50 billion for the OECD and LDC group respectively. A world environment of slower growth, high inflation, heightened caution in the private financial sector, and the continuing threat of energy supply disruptions will simultaneously make the financing of external deficits and the adjustment of national economies to reduce those deficits more difficult.

The private financial sector will again be called upon to meet the bulk of expanding international financing needs, and we believe that the private banking system, including the U.S. banks, can and will continue to participate in the recycling process without incurring undue risk. At the same time, our regulatory authorities will be monitoring developments closely to help insure that the banks' loans are sound and that excessive concentrations do not arise. Moreover, flows of official development assistance will continue to rise. But we have to anticipate that a number of countries, developed and developing, will encounter growing financial difficulties, and pressures to adjust and bring their external positions closer into line with sustainable flows of financing. This will result in increased demands for official balance of payments financing, and early in 1980, the IMF is already processing requests for balance of payments financing that far exceed the total drawn in 1979 as a whole.

The IMF must have adequate resources -- and this means adequate quotas -- to encourage countries to adjust in an appropriate way, rather than adopt trade and capital restrictions, aggressive exchange rate policies, or unduly restrictive domestic measures in order to reduce their financing needs. Such restrictive measures could have serious implications for the entire world economy and the prosperity of all nations, as well as for the economy of the country introducing them. We must not forget the lessons of the 1930's, when serious economic troubles were worsened by ultimately self-defeating actions of nations trying individually to preserve employment and prosperity during times of economic distress and international tension. The impact on the United States today could be especially harmful. Our economy has grown heavily reliant on world trade and financial flows. An interdependent world brings real economic benefits, but also greater vulnerability to outside developments. Imported goods, from raw materials to high technology products, are integrated into all phases of U.S. economic activity. Export markets constitute a major source of demand for U.S. goods and services. One out of every seven U.S. manufacturing jobs and one out of every three acres of U.S. agricultural land produce for export. For the U.S. economy specifically and the world economy generally, prosperity is dependent on a well-functioning international financial system.

Uncertainties about the magnitude, distribution, and financing of payments imbalances over the next few years make it impossible to project the precise level of IMF resources that will be used during the next five years. But we must assure ourselves that the IMF's resources are sufficient to enable it to meet its important responsibilities -- sufficient as measured against historic standards and current trends, and sufficient against a realistic appreciation of the dangers we face as we enter a new decade.

The IMF and National Balance of Payments Adjustment Programs

Let me turn, Mr. Chairman, to the IMF's role in fostering balance of payments adjustment on the part of its member countries. This is an area that has drawn a great deal of public attention in recent years, and one in which the IMF is again likely to become quite heavily involved as its members address the difficult problems they now face.

In trying to gain an understanding of the appropriate role for the IMF, it is important to bear in mind the purpose for which it provides financing -- to help members overcome their balance of payments problems without recourse to measures destructive of national or international prosperity.

Access to IMF financing is contingent upon the member meeting certain criteria which are designed to ensure that the IMF's financial resources are used in a manner consistent with this purpose. In the initial stages of a member's use of IMF financing, the requirement is simply that the member have a balance of payments need. As a member makes greater use of regular Fund resources, it must demonstrate that it is making "reasonable efforts" to overcome its balance of payments difficulties. And if there is a need for further financing from the Fund -- and the member begins to enter into the higher stages of its access to Fund resources -- the IMF requires that a comprehensive adjustment program be developed by the member that provides "substantial justification" in terms of correcting the country's balance of payment problems. Such programs generally involve the use of certain "performance criteria" which establish concrete policy objectives and which are used at regular intervals during the program as indicators of the progress being made toward those objectives. This progression of policy requirements is what is referred to as Fund "conditionality."

It is generally agreed that the "conditionality" attached to IMF lending is essential to achievement of the IMF's purposes. Whatever the cause of a country's balance of payments problem, unless it is temporary and self-reversing, the country will ultimately have to adjust -- it cannot indefinitely spend reserves and borrow abroad. Restrictions on trade and on exchange transactions may provide temporary relief, but can lead to retaliation from abroad and to pervasive distortions in the economy which often compound the member's economic problems. If policy adjustments are delayed too long, the country's creditworthiness and ability to borrow abroad will inevitably decline; trade credit will evaporate; investment and productivity will generally fall; and growth will decline or become negative. This in itself is one form of adjustment, but it is a harsh and inefficient adjustment. What may look like the easy way out is in fact very costly.

Most governments will make policy adjustments before the situation deteriorates to that extreme, but sometimes a country will not approach the Fund until the situation is desperate. This is a key point to remember. The Fund does not <u>cause</u> the lack of foreign exchange that interrupts vitally needed imports. Indeed the IMF, oftentimes alone, tries to help by providing resources to maintain the economy and balance of payments temporarily, and by providing policy advice that will help the borrower restore sustained economic stability and growth. In return for this financing, the world community expects the government to foreswear measures disruptive to the world economy. To assure repayment and the most beneficial results for the country, the Fund requires that the member undertake appropriate measures to solve its balance of payments problem. But barring a major change in the country's economy -- such as discovery of oil or a political decision by other nations to finance the deficits of the country, on a more or less <u>permanent</u> basis -- every nation will have to adjust. In most cases the sooner needed adjustments can be initiated the better since the longer adjustment is delayed, the more difficult and painful it will be.

Quite often, the adjustments that must be made require difficult policy choices for the country concerned and can involve short-term restraint and hardship affecting virtually all segments of the population. The immediate difficulties of a relatively short-term restraint program must be weighed, however, against the pervasive, destructive -- and lasting -- effects of an inflation that is allowed to go unchecked on investment, employment, development, and general welfare. If the IMF can help a country to restore a sound basis for growth and development through implementation of an adjustment program, then the longer-term benefits, economic and social, can far outweigh the shorter-term costs.

This does not mean that the IMF should take a rigid or doctrinaire approach in dealing with its members. Indeed, it is widely overlooked that the institution has, in fact, adapted its policies and practices and taken a large number of steps to improve its effectiveness and ability to respond to members' changing needs.

First, reflecting the generally increased scale and persistence of balance of payments problems, the IMF now provides more financing for longer periods for nations with adjustment problems. Quota limits on drawings have been expanded; and for drawings with higher conditionality, in the upper credit tranches, two and three year programs have become much more the accepted rule, in contrast to the one-year program that was traditional in earlier days.

In addition, a variety of IMF facilities are now available to members, ranging from unconditional reserve tranche drawings through facilities such as the Compensatory Financing Facility and the first credit tranche (both with relatively "light" conditionality requirements) to the upper credit tranche and Extended Fund Facility drawings. Of total drawings amounting to nearly $30 billion since 1973, roughly two-thirds has been drawn from unconditional or relatively unconditional facilities. Some countries have, of course, gotten into more serious difficulty and have had to turn to the more conditional facilities -- which have themselves been expanded and adapted -- and these are the cases one hears about most often. But it is important to bear in mind the whole spectrum of IMF financing facilities when assessing its role in balance of payments financing and adjustment.

Second, the IMF has undertaken a major review of conditionality in the upper credit tranches and has established a new set of guidelines for its application. To an extent, these new guidelines formalize certain protections for borrowing countries that had already existed in practice, but they also add important new features. For example, they now emphasize the desirablity of encouraging countries to adopt corrective measures at an early stage -- before very severe adjustment problems arise -- and recognize the need for more gradual and more flexible adjustment over longer periods. They also recognize that adjustment measures frequently encompass sensitive areas of national policy, and provide that in helping to devise adjustment programs the Fund will pay due regard to the concerns of governments about the compatibility of such programs with their domestic social and political objectives and economic priorities. They provide that "performance criteria" will normally be confined to macro-economic variables (other than those performance criteria needed to implement specific provisions of the Articles, such as the avoidance of exchange restrictions). The new guidelines should help dispel the idea that conditionality is a weapon for imposing unnecessary hardship and make clear that for countries with severe imbalances, the adequate and timely adjustment which is the objective of IMF conditionality is in the best interests of both the individual country involved and the world community.

A third change in the IMF's approach to adjustment, and a particularly important one, is one that I mentioned earlier -- its new role in surveillance. Surveillance over every IMF member's efforts to foster orderly underlying economic and financial conditions provides valuable IMF leverage for promoting sound adjustment policies by all countries, surplus or deficit, whether or not they draw on the IMF's resources. It is designed to introduce a badly needed symmetry in the international monetary system, more effectively encouraging adjustment efforts by surplus countries, and not leaving the entire burden of adjustment on deficit countries. Development of IMF surveillance can be helpful in various ways. To the extent it encourages earlier adjustment action, it helps to avoid the more severe corrective measures which become necessary as a country's situation worsens; and to the extent it encourages adjustment action by all countries with large imbalances, it reduces the relative emphasis on those deficit countries drawing upon the IMF.

Thus the IMF is making a continuing effort to adapt to the changing needs and circumstances of its members. This process should, and will, continue. But as we move to adapt IMF policies and practices, we need to keep the IMF's basic purposes clearly in view, and ensure that its programs do, in fact, effectively promote adjustment by its members. This is in the individual borrower's own interests and of the international community as well.

Budgetary Treatment of IMF Quota Increase

Before I conclude, Mr. Chairman, let me briefly mention the question of the budget and appropriations treatment of this quota increase. The President's budget proposes that a program ceiling on the increase be provided in an appropriations act. We have been consulting closely on this question with interested committees, and considerable interest has developed in an alternative approach which would involve the following elements:

-- Appropriations would be required in the full amount of the increase, and that sum would be included in budget authority totals for fiscal year 1981.

-- Payment of the quota increase by the United States would result in budgetary outlays only as cash transfers are actually made to the IMF on the U.S. quota obligation (25 percent of our quota increase will be transferred immediately in the form of SDRs; subsequent transfers can occur when dollars are needed by the IMF in its operations).

-- Simultaneously with any cash transfer under the quota subscription, an offsetting budgetary receipt, representing an increase in the U.S. reserve position in the IMF, would be recorded.

-- As a consequence of these offsetting transactions, therefore, transfers to and from the IMF under the quota obligations would not result in net outlays or receipts.

-- Net outlays or receipts resulting from exchange rate fluctuations in the dollar value of the SDR-denominated U.S. reserve position in the Fund would be reflected in the Federal budget. These net changes cannot be projected and thus would be recorded only in actual budget results for the prior year.

We are continuing our consultations on this matter. The point I would stress today is that under <u>either</u> the program ceiling contained in the President's budget or this alternative approach, U.S. payments on its quota subscription would not affect net budget outlays or, therefore, the Federal budget deficit.

<u>Conclusion</u>

Mr. Chairman, the proposed quota increase is important for three reasons.

First, from the point of view of the international monetary system as a whole, it will help assure that the IMF can continue to meet its responsibilities for international monetary stability in a period of strain, danger, and financial uncertainty.

Second, from the point of view of individual countries, it will provide additional resources to encourage cooperative balance of payments adjustment policies -- and I note that IMF resources have been of major direct benefit to the United States when we faced severe balance of payments pressures.

Third, from the point of view of the United States, it maintains our financial rights and our voting share in the institution during a time when far-reaching changes in the monetary system -- for example, a substitution account -- may be under consideration.

The record of the IMF is a good one in adapting to changing world circumstances and responding to the needs of its members. The proposed quota increase will provide the Fund with resources needed for its valuable work, and I urge the Committee to approve this legislation.

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WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE March 10, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,300 million of 13-week bills and for $3,300 million of 26-week bills, both to be issued on March 13, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 12, 1980			26-week bills maturing September 11, 1980		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	96.163	15.179%	16.00%	92.497 a/	14.841%	16.27%
Low	96.085	15.488%	16.34%	92.417	14.999%	16.46%
Average	96.112	15.381%	16.23%	92.439	14.956%	16.40%

a/ Excepting 1 tender of $5,000,000

Tenders at the low price for the 13-week bills were allotted 46%.
Tenders at the low price for the 26-week bills were allotted 70%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 75,645	$ 75,645	$ 63,920	$ 63,920
New York	4,545,225	2,341,725	4,361,770	2,573,770
Philadelphia	45,465	45,465	24,780	24,780
Cleveland	81,525	81,015	56,585	46,585
Richmond	64,185	64,185	69,545	69,545
Atlanta	79,580	79,580	54,150	53,150
Chicago	350,775	200,775	339,685	169,685
St. Louis	54,060	45,060	33,845	24,845
Minneapolis	12,500	12,500	9,175	9,175
Kansas City	79,795	79,795	51,155	50,015
Dallas	28,195	28,195	15,715	15,715
San Francisco	351,215	166,215	300,460	112,980
Treasury	79,975	79,975	86,050	86,050
TOTALS	$5,848,140	$3,300,130	$5,466,835	$3,300,215
Type				
Competitive	$3,631,355	$1,083,345	$3,248,135	$1,081,515
Noncompetitive	1,133,390	1,133,390	753,300	753,300
Subtotal, Public	$4,764,745	$2,216,735	$4,001,435	$1,834,815
Federal Reserve	924,195	924,195	920,000	920,000
Foreign Official Institutions	159,200	159,200	545,400	545,400
TOTALS	$5,848,140	$3,300,130	$5,466,835	$3,300,215

1/Equivalent ~~coupon~~-issue yield.

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DATE: March 10, 1980

	13-WEEK	26-WEEK
TODAY:	15.381%	14.956
LAST WEEK:	15.136%	14.792

HIGHEST SINCE:

	EVER	EVER

LOWEST SINCE:

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

TRANSCRIPT OF REMARKS BY
THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE U.S. TREASURY
AT THE PRESENTATION OF A GOLD MEDAL AUTHORIZED
BY ACT OF CONGRESS
AT THE CAPITOL
MARCH 6, 1980

Ladies and gentleman, not only from the Congress and from the public, but, ladies and gentleman of the Wayne family. It's a very special privilege and pleasure for me to be here for a number of reasons. One, I've just left a meeting to discuss the economic policies of our nation, and it's nice to have a respite from that, and to come to a subject that's related. Because you cannot talk about John Wayne--his life and his contribution--without thinking about the inherent strengths and capacities and meaning of our country.

The second reason I'm happy to be here is that I rarely get to be in such elegant company. And I'm delighted to be able to see the wonderful people who have known and loved and been a part of John Wayne's life.

And another reason, of course, is that this is the most popular medal that we've ever struck. So we have a winner. And in that sense, the United States is not only recognizing a great American but is making that recognition available to many, many Americans who share that sense.

When you think of John Wayne, whether he was portraying a fighting Marine, or whether he was that indomitable Western cowboy, he always projected that sense of admiration, of love and affection for his country. Whether he was on the screen or off the screen, he always contributed to that spirit of our great nation.

He spoke in terms of affection for America and the freedom that allowed all the people to thrive and to make their way in this world against odds that may have impeded us as we started on our individual progress. In a substantial way, he projected a vision of a strong human being, the kind of strong human being that each of us hopes to be. Some people called him a legend, some even called him a national resource, but no matter how others pictured John Wayne or Duke, as his friends knew him, he always possessed honor and dignity and was unashamed of affection for his homeland.

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In authorizing the striking of this gold medal, Congress has placed John Wayne among the most illustrious group of the nation's outstanding individuals. Only a small number of Americans have received this kind of honor. The distinguished group includes George Washington, Andrew Jackson, Jonas Salk, Thomas Edison, Charles Lindbergh, Marian Anderson--great names.

It is not difficult to perceive the patriotism of this remarkable man. He espoused faith in America time and again, in his speeches, in his personal relations, and always through the films he appeared in. He saw his films and his roles as a catalyst for stirring our feelings for America. He acted in and financed the film entitled "The Alamo" so that, in his words, he could recreate a moment in history that will show this generation of Americans what their country stands for, what some of their forebears went through to win what they had to have or die--liberty and freedom.

At this time in our history it is important for us to remember that patriotism is an acceptable demonstration of our faith in our country. John Wayne was a patriot. He wanted his own children to understand American ideals and to adhere to them. He stated one time that he was grateful each day of his life to wake up in the United States of America. He wanted his children to also have that sense of gratitude. He said about his daughter, I don't care if she memorizes the Gettysburg Address, but I hope she understands it.

It's interesting that he should have used Abraham Lincoln's address as the embodiment of his feelings, because he was shown in a recent poll to be second only to Abraham Lincoln as a name and a face most readily recognized by all Americans.

So it's therefore appropriate today that we honor his memory and his impact and his contribution upon the American scene, by a presentation of the Presidential medal, which is shown in replica here, inscribed very simply and very eloquently, "John Wayne, American." This is the replica, but this is the real medal in gold. And it may be the last time that Congress, if it's going to balance the budget, will be able to do this. So to the family, I would like to present the gold medal that has been made available by an act of the Congress of the United States.

Congratulations.

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

FOR RELEASE AT 4:00 P.M. March 11, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $6,600 million, to be issued March 20, 1980. This offering will provide $250 million of new cash for the Treasury as the maturing bills are outstanding in the amount of $6,347 million, including $975 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,933 million currently held by Federal Reserve Banks for their own account. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,300 million, representing an additional amount of bills dated December 20, 1979, and to mature June 19, 1980 (CUSIP No. 912793 4K 9), originally issued in the amount of $3,222 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,300 million to be dated March 20, 1980, and to mature September 18, 1980 (CUSIP No. 912793 5F 9).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing March 20, 1980. Tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the weighted average prices 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, March 17, 1980. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

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

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. 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 March 20, 1980, in cash or other immediately available funds or in Treasury bills maturing March 20, 1980. 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.

epartment of the TREASURY NEWS
ASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
MARCH 10, 1980

Contact: George G. Ross
202/566-2356

JUNE GIBBS BROWN AND ANTHONY PICCIRILLI
RECEIVE 1979 FINANCIAL MANAGEMENT IMPROVEMENT AWARDS

Treasury Deputy Fiscal Assistant Secretary, Gerald Murphy and Comptroller General Elmer B. Staats, presented the 1979 Financial Management Improvement Awards to June Gibbs Brown, Inspector General of the Department of the Interior and Anthony Piccirilli, Auditor General of the State of Rhode Island on March 3, 1980. They were recognized for their outstanding contributions to the improvement of financial management in the public sector at the Ninth Annual Financial Management Conference in Washington, D. C., sponsored by the Joint Financial Management Improvement Program (JFMIP).

The JFMIP is a joint and cooperative undertaking of the Department of the Treasury, the General Accounting Office, the Office of Management and Budget and the Office of Personnel Management to improve financial management practices throughout the Government.

June Gibbs Brown was commended for her dynamic and outstanding leadership in establishing the Office of Inspector General at the Department of the Interior. Through her efforts, the principles and integrity anticipated by the Inspector General Act of 1978 are beginning to be realized through a climate of mutual concern at all levels of management. She has installed an aggressive managerial and organizational style to ensure a response to every allegation received in the Office of the Inspector General and has designed a management information system to provide management feedback on the status of all audit report recommendations.

Mrs. Brown was recognized as one of the most outstanding financial systems design experts in the Federal Government, having worked on several large complex systems for the U. S. Navy and the Department of the Interior. She created a new automated system for payrolling and processing personnel actions for the Department of the Interior, that utilizes the latest concepts in data transmission, computer processing, financial reporting and internal control. Several Federal agencies have adopted this system for their own use.

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Mr. Anthony Piccirilli, Auditor General of Rhode Island, was commended for his dedication, initiative and imagination in making the Office of the Auditor General a vital force in Rhode Island State Government. Through the issuance of audit reports to the State legislature on a wide range of State programs and services from education to health to transportation, he has triggered improvements in many State services and financial management practices throughout the Rhode Island State Government.

Under his leadership, the Office compiled an accounting manual providing guidance for local governments in Rhode Island. The impact of the manual is already evident in the increased adherence on the part of municipalities to generally accepted accounting principles and auditing standards and the publication of more meaningful financial information to the public.

Mr. Piccirilli has also been very active in the Intergovernmental Audit Forums that promote cooperation and coordination of audit efforts among Federal, State and local governments. While serving as chairman of the New England Intergovernmental Audit Forum, he has been instrumental in developing guidelines for the conduct of quality reviews of audit organizations that perform audits of government programs.

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

FOR RELEASE AT 4:15 P.M. March 12, 1980

TREASURY TO AUCTION 2-YEAR AND 4-YEAR NOTES
TOTALING $6,000 MILLION

The Department of the Treasury will auction $3,500 million of 2-year notes and $2,500 million of 4-year notes to refund $5,267 million of notes maturing March 31, 1980, and to raise $733 million new cash. The $5,267 million of maturing notes are those held by the public, including $1,279 million of maturing notes 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 $809 million of the maturing notes that may be refunded by issuing additional amounts of the new notes at the average prices of accepted competitive tenders. Additional amounts of the new securities may also be issued at the average prices to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that their aggregate tenders for each of the new notes exceed their aggregate holdings of the maturing notes. For purposes of determining such additional amounts, foreign and international monetary authorities' holdings of the maturing notes are considered to be made up of $309 million of original 4-year notes and $970 million of additional 2-year notes.

Details about the new securities are given in the attached highlights of the offering and in the official offering circulars.

Attachment

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HIGHLIGHTS OF TREASURY
OFFERINGS TO THE PUBLIC
OF 2-YEAR AND 4-YEAR NOTES
TO BE ISSUED MARCH 31, 1980

March 12, 1980

Amount Offered:		
To the public	$3,500 million	$2,500 million
Description of Security:		
Term and type of security	2-year notes	4-year notes
Series and CUSIP designation	Series Q-1982 (CUSIP No. 912827 KN 1)	Series D-1984 (CUSIP No. 912827 KP 6)
Maturity date	March 31, 1982	March 31, 1984
Call date	No provision	No provision
Interest coupon rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction
Interest payment dates	September 30 and March 31	September 30 and March 31
Minimum denomination available	$5,000	$1,000
Terms of Sale:		
Method of sale	Yield Auction	Yield Auction
Accrued interest payable by investor	None	None
Preferred allotment	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
Deposit guarantee by designated institutions	Acceptable	Acceptable
Key Dates:		
Deadline for receipt of tenders	Thursday, March 20, 1980, by 1:30 p.m., EST	Tuesday, March 25, 1980, by 1:30 p.m., EST
Settlement date (final payment due)		
a) cash or Federal funds	Monday, March 31, 1980	Monday, March 31, 1980
b) check drawn on bank within FRB district where submitted	Wednesday, March 26, 1980	Friday, March 28, 1980
c) check drawn on bank outside FRB district where submitted	Tuesday, March 25, 1980	Friday, March 28, 1980
Delivery date for coupon securities	Monday, April 14, 1980	Monday, April 14, 1980

epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

RELEASE ON DELIVERY
March 17, 1980
Expected at 10:00 A.M.

STATEMENT OF THE HONORABLE WILLIAM W. NICKERSON
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT)
BEFORE THE
SUBCOMMITTEE ON TRADE
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

Mr. Chairman and members of the Subcommittee,

I thank you for inviting me here today to discuss H.R. 5961 - a bill to amend the Currency and Foreign Transactions Reporting Act (a part of the Bank Secrecy Act) - and why the Treasury Department so urgently requests its passage. As you may be aware, we testified on behalf of the provisions of this bill before the House Banking Committee last November. Subsequent to our testimony, the bill, with a few minor amendments, was reported out of the Banking Committee. We urge you to carefully consider the merits of the bill. We believe that after having done so, you will support it.

Title I of the bill would amend section 231(a) of the Bank Secrecy Act to make it illegal to <u>attempt</u> to export or import currency or other monetary instruments without filing the required reports. Title II would amend section 235 of the Act to authorize Customs officers to search suspected individuals at the border for currency and other monetary instruments without a search warrant when they have a reasonable cause to suspect that those persons are in the process of transporting monetary instruments for which a report is required. Title III would add a new section to the Act which, by offering as a reward a percentage of funds recovered, would encourage people to supply information to the Government about individuals who have violated the reporting provisions of the Currency and Foreign Transactions Reporting Act. The Banking Committee has amended the bill by increasing the amount which need not be reported from $5,000 to $10,000, by requiring that the Treasury Department report to the Congress within 18 months after the effective date on the results produced by the bill's provisions, and by postponing the effective date of the bill to October 1, 1980.

I would like to emphasize that this bill would impose no additional reporting requirements on travellers.

Although we have good reason to believe that, at a minimum, hundreds of millions of dollars were carried or shipped out of the United States to purchase illegal drugs, we have been able to detect only a very small part of those funds. In 1978, for example, less than $46 million was reported as being transported to drug significant countries. It is obvious to us that we are not receiving all of the reports that should be filed, and these amendments are needed to help us deal with this problem.

The best way to illustrate the problems we encounter in enforcing the currency reporting requirements is to compare the situation we face when an individual enters the United States to the situation when he leaves.

Imagine an individual arriving by plane from abroad with $50,000 in cash in his luggage. As he approaches the U.S. Customs inspector for routine inspection and clearance, he is notified of his legal obligation to file the Customs Form 4790 (Report of the International Transportation of Currency and Other Monetary Instruments) because a specific question concerning this obligation appears on the baggage declaration form given to him on the airplane. In addition, signs notifying travellers of this requirement are posted at ports of entry and verbal notice of the requirement may also be given by Customs personnel. Should he attempt to avoid filing this form, it is conceivable that the currency would be discovered by the Customs inspector in the course of the routine inspection. If the individual declines to file the report after being specifically advised of his obligation to do so, and the currency is discovered, there is no question that a violation of the Act has occurred. The individual has clearly transported the currency into the United States without filing a report, and the Customs inspector clearly had the authority to search his baggage. This violation can easily be expanded through investigation by Customs agents to determine whether the funds were transported in furtherance of a violation of another Federal law. This is the easy case.

Imagine, however, a private airstrip in Florida, where a small private jet has taxied out on the runway as an impeccably dressed man, carrying an attache case, walks out to meet the plane. A Customs officer, on the scene only because he had just received an anonymous phone call that someone was leaving for a known narcotics producing country from that airport with $250,000 in cash, stops the well-dressed man and asks where he is going. After the man indicates that he is going abroad, the Customs officer asks if he is carrying more than $5,000 in currency or monetary instruments, and if so, states that a report must be filed. The man responds in the negative, at which time the Customs officer opens the attache case and discovers that it is filled with $100 bills. This individual could very well escape prosecution.

In this situation, the individual had not yet departed from the United States when the Customs officer stopped him. Although there is little doubt that within the next five minutes he would have been airborne, transporting the $250,000 without having filed the required report, and beyond the reach of Federal law enforcement authorites, some courts have held that it is not a violation of the Act to attempt to transport currency out of the United States without filing the report and the actual violation does not occur until the individual has left the United States and is therefore beyond our jurisdiction.

This incident also dramatizes the limitation on the scope of the Customs authority to verify the individual's negative response by opening the attache case. In this instance, the facts leading to the search very likely do not constitute probable cause, the search standard in the Act. Thus, even if there is a violation of the Act, the evidence may be suppressed. It is evident that under existing statutes the Customs inspector has much greater authority to examine an incoming individual's luggage, which gives him a good opportunity to discover a violation of the reporting requirement. Customs is, however, virtually powerless to enforce the Act with respect to departing travellers.

Another problem is providing coverage at the place of departure. Customs personnel are not generally stationed at smaller airports or even major departure ports, as they are at points of entry. There is no routine screening of individuals as they leave the United States. Therefore, to a very large degree we must rely on prior information to alert us to future departures. In the case cited, the officer had received a phone call which proved to be reliable. However, with our present resources, we must be selective and thus may not always be able to respond to every anonymous tip. We must develop sources of information concerning the financial operations of organized narcotics traffickers. To encourage people who have this sensitive information to contact the law enforcement community, it is, unfortunately, sometimes necessary to offer something valuable in return. Often, the informant risks his life by giving information on major criminal activities and therefore substantial payment may be necessary. It should be noted, however, that this amendment will not cost the Government anything. Payments will only be made after a substantial recovery has occurred.

In sum, we believe that the problems we are currently facing in enforcing the Act with respect to departing violators would be greatly alleviated if H.R. 5961 were enacted.

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

FOR IMMEDIATE RELEASE March 17, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,300 million of 13-week bills and for $3,302 million of 26-week bills, both to be issued on March 20, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 19, 1980			26-week bills maturing September 18, 1980		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	96.197	15.045%	15.86%	92.460	14.914%	16.35%
Low	96.187	15.084%	15.90%	92.422	14.989%	16.44%
Average	96.195	15.053%	15.87%	92.442	14.950%	16.40%

Tenders at the low price for the 13-week bills were allotted 15%.
Tenders at the low price for the 26-week bills were allotted 32%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 80,530	$ 78,555	$ 55,385	$ 54,790
New York	6,087,740	2,578,645	5,303,025	2,644,280
Philadelphia	48,255	42,625	24,855	24,155
Cleveland	68,770	65,030	46,300	35,190
Richmond	64,260	58,540	64,460	44,460
Atlanta	83,050	77,020	59,985	49,245
Chicago	420,425	72,055	380,075	83,775
St. Louis	58,530	30,530	47,940	19,940
Minneapolis	17,260	11,260	14,425	8,415
Kansas City	54,110	53,610	43,790	39,625
Dallas	32,940	27,940	24,570	23,570
San Francisco	391,170	127,525	358,385	185,910
Treasury	76,685	76,685	88,925	88,925
TOTALS	$7,483,725	$3,300,020	$6,512,120	$3,302,280
Type				
Competitive	$4,929,400	$ 745,695	$4,450,310	$1,240,470
Noncompetitive	1,103,785	1,103,785	747,010	747,010
Subtotal, Public	$6,033,185	$1,849,480	$5,197,320	$1,987,480
Federal Reserve	763,570	763,570	1,170,000	1,170,000
Foreign Official Institutions	686,970	686,970	144,800	144,800
TOTALS	$7,483,725	$3,300,020	$6,512,120	$3,302,280

1/Equivalent coupon-issue yield.

M-372

DATE: March 17, 1980

	13-WEEK	26-WEEK
TODAY:	15.053%	14.950%
LAST WEEK:	15.381%	14.956%
HIGHEST SINCE:		
LOWEST SINCE:		
2-25-80	13.700%	~~3-3-80~~
3-3-80		14.792%

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

STATEMENT OF EMIL M. SUNLEY
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR TAX POLICY (TAX ANALYSIS)
ON TAX EXPENDITURES FOR HEALTH CARE
BEFORE THE HEALTH SUBCOMMITTEE OF THE
SENATE FINANCE COMMITTEE
MARCH 18, 1980

Mr. Chairman and Interested Members:

I am pleased to appear here today to discuss the role of the tax system in the provision of private health insurance and health care, and to examine in particular its effect on competition and cost consciousness. It is especially beneficial for the national debate that this subcommittee can examine the role of tax expenditures as it reviews the President's National Health Plan, the Health Incentives Reform Act of 1979, and other proposals for national health insurance or for restructuring incentives in the private health care sector.

Current Tax Treatment

Over $16 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 nonaged, nonpoor population, and they exceed the $14 billion of Federal contributions to medical care for the poor.

Specifically, the tax system subsidizes the purchase of medical care by 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 $16 billion relates to the Federal income tax alone. There is a further tax expenditure cost of about $3 billion to States with income taxes. In addition, social security tax revenues are reduced by about another $6 billion. In total, Federal and State revenues are reduced by about $25 billion because certain health expenditures are allowed to be excluded or deducted from income and social security tax bases.

In addition, another $0.4 billion dollars of Federal tax revenue is forgone each year because interest income from certain hospital bonds is tax exempt.

As for many tax expenditures, I am not sure that Congress, if starting over, would determine that the 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 debate on Federal health policy currently being undertaken by the Congress is a convenient and crucial opportunity to reexamine health tax 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 5 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 5 percent floor was lowered to 3 percent, and an additional 1 percent floor was applied to expenses for drugs before those expenses could be counted toward the overall 3 percent floor. A major justification for both actions was that deductions should be allowed for all "extraordinary" expenses. While a 5 percent floor was considered too high to cover all extraordinary expenses, a 1 percent floor was considered necessary to exclude ordinary drug expenses.

Besides the 1 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. In any case, for 1977, (the most recent data available) only 19 percent of taxpayers benefit from the medical deduction and 43 percent of these only deduct one-half of their insurance premiums.

The tax saving from the itemized deduction rises with income. Of course, the deduction is of no value to the nonitemizer. However, even among returns with itemized medical deductions, the average tax expenditure per return increases as income increases. This increase, in what essentially is a subsidy for the purchase of medical care, is the result of several factors, including higher marginal tax 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.

Exclusion of Employer-Paid Premiums for Medical Insurance

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 noncash 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 nontaxable 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 $13 billion in 1980.

The distribution of benefits from the exclusion--a subsidy for the purchase of medical insurance through an employer, with the subsidy rate increasing with income--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 or the level of their expenditures. (But approximately 16 percent of all employees do not have group health and, presumably, do not receive employer-paid health insurance premiums.) Below tax-exempt levels of income, of course, there is no employee gain from either the exclusion or the deduction.

Exclusion of Interest Income From Tax-Exempt Bonds

Prior to 1968, interest on IDB's issued by State and local governments had been exempt from Federal income taxation even though the proceeds were used by private persons. The use of such IDB's had been growing in importance as a mechanism by which State and local governments sought to attract plants to their communities. Through the use of IDB's, these governments had been able to extend the tax exemption afforded to interest on their securities issued for public investment to interest on bonds issued for essentially private purposes. Of course, as many States and localities came to utilize this method, the competitive advantage was lost and the increased volume of tax-exempt financing affected the interest cost of public issues. These factors, and fear of increasing revenue losses to Treasury as use of this method of financing long-term private debt expanded, led to the limits on tax-exempt IDB's included in the Revenue and Expenditure Control Act of 1968.

Under present law, the definition of a taxable industrial development bond generally does not include an obligation issued to finance a trade or business carried on by a private, nonprofit charitable organization. Thus, many bonds issued by State and local governments to finance facilities for private, nonprofit hospitals are not considered to be taxable IDB's and are eligible for tax exemption on the grounds that they have been issued directly by States and localities. About $3.5 billion of tax-exempt hospital bonds were issued in 1979.

Effect of Tax Expenditures for Health on
the Demand and Price of Medical Care

I believe that this subcommittee is 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 exenditure that can occur. 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 is equal to only $0.80 in nontaxable compensation. The tax incentive lowers the price of the nontaxable fringe benefit and thereby creates a 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 noncash 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 may be 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 about 4 percent in 1980.

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 may be reflected in a reduction of the deductible amount or the copayment rate, 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 3 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. Although the evidence is not conclusive, some researchers have found that a small deductible has little effect on the demand for hospitalization, while, for ambulatory and other nonhospital services, a moderate-size deductible is likely to influence demand markedly.

While the 3 percent floor is roughly analogous to a deductible in an insurance policy, the exclusion of employer premiums and the deduction of all expenses above 3 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 services is greater the higher the taxpayer's taxable income.

The quantitative 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 $16 billion cover approximately 10 percent of total private expenditures for health care. At the margin, however, the reduction in price is much greater than 10 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. 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 conditions in both the supply and demand sides of the market. 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 noncatastrophic events than for uncontrollable or catastrophic occurrences. That is, demand for some basic level of health care or insurance may not be responsive to price, but the demand for additional health care or insurance may be much more responsive. This certainly deserves more study.

Insurance complicates considerably the analysis of 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). To the extent that demand responds to price incentives, tax subsidies then lead to increased insurance coverage. Increased coverage may take the form of lower deductibles and copayment rates on medical goods actually purchased, or it may increase benefits. 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 cost changes, over time, are determined by forces or events not subject to the usual limits of market behavior.

Because tax subsidies tend 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.

In issuing industrial development bonds, a State or local government essentially lends its tax exemption to a private business to enable it to finance facilities at the lower interest rates prevailing in the tax-exempt market. This construction subsidy increases the flow of capital into the hospital sector and out of other areas in the economy. The resulting excess hospital capacity in turn increases the cost of hospital stays.

Dealing with the Problem

There is sufficient reason to be concerned about the tax and economic policy problem that tax expenditures contribute to high and rising medical care prices. This problem has led some observers, including members of this subcommittee and other members of the Congress to seek ways to reduce the inflationary properties of medical care subsidies. In fact, they have proposed to redesign existing tax expenditures in a way that will provide leverage for promoting competition and developing consumer cost consciousness--a rare attribute among us eunuches who waive the responsibility for decisions about medical care to our physicians who are compensated on a fee-for-service basis by third party payers with little if any interest in cost control. Although I would not consider such proposals a panacea, in my opinion this approach can play a significant role in restraining increases in medical care prices.

The Health Incentives Reform Act, sponsored by Senators Durenberger, Boren and Heinz, would enhance competition among types of medical care delivery systems by granting favorable tax treatment to contributions of employers of over 100 people only if three conditions are met: employers offer a choice of at least three health insurance or delivery plans; employees choosing lesser cost options would receive a cash rebate in lieu of higher health insurance premiums; and all plans must include coverage of catastrophic medical expenses which exceed $3500 out-of-pocket in any one calendar year.

Determining the appropriate tax on the rebate brings forth a dilemma. A legitimate health policy view is that the rebate should be nontaxable and thus play a neutral role--i.e., not be a bias for or against money wages versus the employer-paid premium which itself is nontaxable. However, a nontaxable rebate provides an incentive to convert taxable wages into a nontaxable rebate. This could result in a revenue loss of about $2 billion per year even without any increase in health insurance purchases. To avoid this problem, the Health Incentives Reform Act makes the rebate subject to the individual income tax. However, in his plan, the rebate is not subject to employer-paid FICA and FUTA taxes, thus preserving the existing policy of not including most employer-paid fringes to the employer's FICA or FUTA tax base.

The Health Incentives Reform Act would also limit to $125 per month per family the amount of the employer contribution that qualifies for taxfree treatment. Because of some health policy concerns, the Administration's plan did not cap the tax-free amount of the employer contribution. The cap also poses some tax administration issues that deserve examination. As described in S. 1968 the cap would perform several functions. It was proposed in combination with a comprehensive benefit package apparently in an attempt to assure that the plans offered will contain significant deductible and copayment provisions (to keep the premium price within the limit) and thus avoid subsidization of first dollar coverage. Also, the S. 1968 cap probably is intended to help limit the total amount of the subsidy--the revenue loss to the Federal budget. And, the cap is proposed presumably as part of an attempt to cover a potential loophole. This loophole could emerge when qualified plans are required to offer both a choice of higher and low-cost plans with an equal contribution by the employer, and a cash rebate of the difference between the high-cost plan and the option chosen by the employee. Without the cap, an employer could "game" the situation by offering a very high-cost plan in an attempt to convert taxable wages into a nontaxable rebate. Making the rebate fully taxable--including income tax, FICA and FUTA--would prevent such gaming and woud eliminate this reason for a cap. The cap has some disadvantages from the perspective of health policy--such as using a single national limit for a subsidy that applies to differently situated workers (age, sex, and geographic location)--and these are discussed in the testimony of my colleagues from HEW.

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 10 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 1 percent floor for drugs. The House of Representatives accepted the simplification aspects of this proposal, but the suggested 10 percent floor was kept at 3 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 3 percent for 25 years, the proportion of income spent on medical expenditures has risen. From 1950 to 1978, total health expenditures, both public and private have risen from 5.9 percent to 14.7 percent of adjusted gross income, while private expenditures have risen from 4.5 percent to around 8.7 percent. What at one time may have been an extraordinary level of medical expenditures may now be only an ordinary or normal level. To the extent that their is time, the 3 percent floor cannot be justified on either equity or incentive grounds. 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 10 percent of adjusted gross income. Although we believe that the floor should be raised--for both equity and incentive reasons-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. Thus, in my judgment, there is sufficient reason to cease allowing deductions for nonextraordinary medical expenses.

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. Antidiscrimination 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, effective in 1983, employers be required to provide for all full-time employees a minimum health insurance plan that has a package of basic benefits (including unlimited hospitalization, physician's services, laboratory tests, selected skilled nursing services, home health, mental health, and other benefits, and free-fee maternal and infant care) with annual out-of-pocket expenditures for covered services limited to $2,500 per family. Employers would also be required to make equal dollar contributions to all plans that they offer, including a rebate of the difference between the contribution for the employer's "primary plan" and a lower cost option selected by the employees, thus encouraging employees to seek out lower cost plans (and thus increasing the employer's relative contribution). 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.

In 1978, the President proposed to limit the use of tax-exempt bonds in financing hospital construction. The Administration is concerned that excess expansion of hospital facilities is increasing costs of medical care and has, therefore, proposed, in its Hospital Cost Containment Act, that the number of certificates of need for hospital construction be drastically reduced. In order further to reduce incentives for construction of excess hospital facilities, the Administration has also proposed to disallow tax-exempt IDB financing for hospitals operated by charitable organizations for which a certificate of need has not been issued. If a need for the facility has been established, interest on the bonds would

As you know, the President has again urged Congress to pass the Hospital Cost Containment Act as part of an overall effort to reduce inflation in the economy.

Summary

In summary, tax expenditures for medical care form a large and growing part of the Federal budget. For 1980, Federal income tax expenditures for medical care will exceed $16 billion and will comprise about 10 percent of total medical expenditures. State income tax and social security tax collections are also reduced by another $9 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 subsidies can reduce price by 29 to 35 percent.

Tax expenditure policy should be explicitly integrated into the current review of national health policies. The design and choice of the exclusion, the deduction and the tax-exempt treatment of hospital bonds should reflect judgments about: 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 these tax subsidies are to be made equally available to all persons; the design of direct health expenditure programs, and the limits that should be placed on tax-induced increases in demand for health insurance and health care. Even without explicit change in the laws affecting them, the amount of health tax expenditures will be affected by changes in virtually all policies connected with medical care.

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

FOR RELEASE AT 4:00 P.M. March 18, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $6,800 million, to be issued March 27, 1980. This offering will provide $550 million of new cash for the Treasury as the maturing bills are outstanding in the amount of $6,254 million, including $670 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,879 million currently held by Federal Reserve Banks for their own account. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,400 million, representing an additional amount of bills dated December 27, 1979, and to mature June 26, 1980 (CUSIP No. 912793 4L 7), originally issued in the amount of $3,228 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,400 million to be dated March 27, 1980, and to mature September 25, 1980 (CUSIP No. 912793 5G 7).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing March 27, 1980. Tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the weighted average prices 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, March 24, 1980. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

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

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. 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 March 27, 1980, in cash or other immediately available funds or in Treasury bills maturing March 27, 1980. 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
WASHINGTON, D.C. 20220 TELEPHONE 566-2041
NEWS

FOR IMMEDIATE RELEASE
March 18, 1980

Contact: Charles Arnold
202/566-2041

CUSTOMS RULES CHANGED TO ENCOURAGE FOREIGN INVESTMENT

The Treasury Department announced today an amendment to the Customs Regulations designed to encourage foreign manufacturing concerns to relocate assembly operations to the United States.

Customs rules governing appraisement of merchandise in foreign trade zones were amended to exclude overhead and labor incurred in a zone from dutiable value. Profit was also dropped.

These changes will provide additional incentive for foreign automobile manufacturers, as well as manufacturers of other products subject to a lower duty on the end product than on the component parts, to shift their manufacturing operations to the United States.

Foreign trade zones are geographically inside the United States but legally outside the nation's customs territory. Their purpose is to attract and promote international trade and commerce.

A copy of the regulation is attached.

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Foreign-Trade Zones--Customs Regulations amended

Section 146.48(e), Customs Regulations, relating to processing costs incurred and profit realized in foreign-trade zone manufacturing operations, amended

TITLE 19--CUSTOMS DUTIES

CHAPTER I--UNITED STATES CUSTOMS SERVICE

PART 146 - FOREIGN-TRADE ZONES

AGENCY: U.S. Customs Service, Department of the Treasury.

ACTION: Final rule.

SUMMARY: The Customs Service includes the cost of processing "non-privileged" merchandise in a foreign-trade zone, and profit realized, in the dutiable value of that merchandise when it enters the customs territory of the United States. The present policy results in Customs assessing duty on the costs of American labor, overhead, facilities, and profit. This document changes Customs appraisement practice so as to exclude the cost of processing and profit realized in a foreign-trade zone when determining the dutiable value of articles produced entirely from nonprivileged merchandise (foreign or domestic), or from a combination of nonprivileged and privileged merchandise (foreign or domestic).

This change results from a Customs review of the existing policy and consideration of the numerous favorable comments received in response to an advance notice and a notice of proposed rulemaking proposing to change the policy. The change is considered to be significant.

EFFECTIVE DATE: (30 days after date of publication in the Federal Register).

FOR FURTHER INFORMATION CONTACT:

Thomas Lobred, Classification and Value Division, U.S. Customs Service, 1301 Constitution Avenue, N.W., Washington, D.C. 20229 (202-566-2938).

SUPPLEMENTARY INFORMATION:

BACKGROUND

A foreign-trade zone ("zone") is established under the Foreign-Trade Zones Act (19 U.S.C. 81a-81u) and the general regulations and rules of procedure of the Foreign-Trade Zones Board contained in 15 CFR Part 400. Part 146 of the Customs Regulations (19 CFR Part 146) governs the admission of merchandise into a zone; manipulation, manufacture, or exhibition of merchandise in a zone; exportation of merchandise from a zone; and transfer of merchandise from a zone into the customs territory of the United States ("customs territory").

On October 4, 1978, an advance notice of proposed rulemaking inviting comments on the advisability of changing current Customs appraisement practice to exclude the cost of American labor, overhead, facilities, and profit when determining the dutiable value of articles produced in a zone entirely or in part from nonprivileged merchandise (foreign or domestic) or from a combination of nonprivileged and privileged merchandise (foreign or domestic), was published in the Federal Register (43 FR 45885). The vast majority of the comments received favored the change proposed in the advance notice.

A notice of proposed rulemaking requesting the public to comment on a specific proposal to change the current appraisement practice and discussing the possible economic effects of the proposed change was published in the Federal Register on May 21, 1979 (44 FR 29489).

DISCUSSION OF COMMENTS

A total of 293 comments were received. Of these, 286 favored the proposal.

In response to Customs discussion of, and request for, comments on the possible economic effects of the proposal, both those who supported and those who opposed the proposal offered principally economic arguments to bolster their position--essentially, that the proposal would be "good" or "bad" for business and the economy. However, legal and other arguments also were made by both sides.

The comments received are discussed below:

FAVORABLE/ECONOMIC

The proposal would

- Help both the national economy and the United States role in international trade by creating greater investment and higher employment in the United States, i.e., United States industry would not have to go abroad.

- Be anti-inflationary.

- Provide an added tax base.

- Increase United States exports because various products are exported from a zone.

- Allow operations presently performed elsewhere to be conducted in the United States; that, in turn, would help the United States balance of payments.

- Remove the unfair burden of double taxation imposed on labor in a zone, especially because local, state, and Federal taxes are imposed upon the investments made in the zone and income generated from the zone.

- Aid local economies through encouragement of investment and creation of new jobs. The use of local zones, as well as the general concept of greater zone use, would be enhanced.

- Result in substantial savings of Customs duties for zone users. Under the present system, it may cost more in duty to use a zone than not to use it.

- Not affect significantly the competitive position of the United States manufacturers of finished products.

- Eliminate, or at least minimize, the disadvantage to zones located in high cost areas in that no duty would be collected on high costs of real estate and labor. Discrimination against zones in high cost areas would end.

- Result in cash flow savings to companies that would deposit duties at the time goods leave the zone, rather than pay duty on finished goods when imported.

FAVORABLE/LEGAL

- The proposal is expressive of the Congressional intent behind the Foreign-Trade Zones Act: to encourage the development of American industry and labor.

- There is no authority under current law to appraise merchandise as Customs presently is doing.

- The Secretary of the Treasury has the authority under the Foreign-Trade Zones Act and section 1624, title 19, United States Code, to fix the basis of duty as set forth in the proposal.

FAVORABLE/MISCELLANEOUS

- Approval of the proposal is recommended because to do otherwise would be unfair and illogical.

- The proposal would encourage the upgrading of port, marine, and terminal facilities, thereby strengthening the American shipping industry and the various ports.

- The proposal would eliminate red tape for importers who now must rely on drawback, the use of bonded warehouses, and temporary importation bonds in connection with zone merchandise.

- The proposal would aid Customs in that the calculation of duty would be less complex.

- The Tariff Schedules of the United States (TSUS) (section 1202, title 19, United States Code) are structured in a manner to encourage, in many instances, the importation of finished products rather than parts to be further processed and combined with United States-origin parts. This built-in disincentive in the tariff schedules can be overcome only by use of a zone.

OPPOSED/ECONOMIC

The proposal would

- Result in injury to United States manufacturers of components.
- Result in injury to United States manufacturers of end-products.
- Reduce demand for domestic raw materials with the resultant loss of jobs.
- Not spur United States exports.
- Not result in any significant increase in United States investment.

OPPOSED/LEGAL

The proposal is contrary to Congressional intent in that value would be added to the product "outside United States commerce", thus in foreign territory, and the added value therefore should be subject to duty.

OPPOSED/MISCELLANEOUS

The proposal would encourage circumvention of existing import restrictions.

All seven commenters who opposed the proposal did so based on one or more of the economic agruments listed above. Two commenters also stated that the proposal would encourage circumvention of existing import quotas.

In some cases, the reduction of the dutiable value of products manufactured in a foreign-trade zone by manufacturers already located in the United States may encourage the use of foreign parts and components. This might be the case if the FTZ manufacturer concluded that the reduction in dutiable value resulting from the rule change made the use of foreign-made parts and components less costly than domestic parts and components, and other factors typically favoring U.S. suppliers, such as delivery time, reliability of source, and quality control, were not important. A much more likely consequence of the change, however, is that it will tend to encourage foreign manufacturers who now assemble their products entirely outside of the United States to transfer some or all of that assembly to foreign-trade zones in the United States.

Customs finds no merit to the contention that the proposal would encourage the circumvention of existing import quotas. The change in appraisement does not in any way change the existing treatment of quota merchandise processed in a zone. With respect to such merchandise, Customs has held that articles manufactured in zones are products of the zones rather than of the countries from which the component materials were obtained. Whether or not a particular quota limitation applies to products entering the customs territory of the United States from a zone depends on the language of the particular quota provision. In situations where a quota limitation does not apply to merchandise manufactured in a zone, the Foreign-Trade Zones Board has the authority to exclude from zones any goods or manufacturing operation that in its judgement is "detrimental to the public interest". 19 U.S.C. 81o(c).

In sum, it is Customs opinion that the proposal, on balance, will be beneficial to United States industries, employment, and the general United States economy by attracting increased assembly and manufacturing operations. Customs is sympathetic to industry concerns regarding zone activity that might affect domestic production adversely. However, as mentioned above, adequate safeguards against domestic injury exist under the regulations of the Foreign-Trade Zone Board.

Two commenters opposed the proposal as contrary to the intent of Congress when the Foreign-Trade Zones Act was enacted. They contend that a zone is "outside United States commerce" and that any value added to merchandise through processing occurs in a "foreign territory" and thus is fully dutiable. Moreover, they contend that neither the Foreign-Trade Zones Act nor the Tariff Act of 1930, as amended, authorizes Customs to adjust the valuation base of merchandise entering from a zone by deducting the value of processing which occurs in a zone.

It is Customs position that those statutes do not address how merchandise which leaves a zone is to be appraised. Certainly, as provided in the Foreign-Trade Zones Act, such merchandise is subject "to the laws and regulations of the United States affecting imported merchandise". However, the laws and regulations regarding appraisement of merchandise ordinarily are concerned with prices and costs in the country of exportation. Thus, for years an anomaly has existed which results in a zone being treated as the "country of exportation" for appraisement purposes. Customs does not believe this was the intent of Congress. As neither the Foreign-Trade Zones Act nor the Tariff Act of 1930, as amended, is explicit on this issue, Customs is not precluded from adopting the proposal for the reasons advanced by these commenters.

In light of the overwhelming public support for the proposal and Customs conclusion that there is no legal impediment to its adoption, section 146.48(e), Customs Regulations, is being amended as set forth in the May 21, 1979, notice of proposed rulemaking, subject to the clarification described below.

CLARIFICATION OF PROPOSED AMENDMENT

One of the commenters in favor of the proposal expressed his understanding that the words "labor cost" were not excluded intentionally from proposed section 146.48(e), but were omitted because the words "processing costs" were thought to be more inclusive and to parallel the language in section 402(d), Tariff Act of 1930, as amended (19 U.S.C. 1401a(d)), pertaining to constructed value. The commenter's understanding is correct. Labor costs are an element of processing costs.

Because of another comment, the proposal has been clarified to specify that the cost of fabrication or other processing includes general expenses and all other expenses incident to placing the merchandise in condition, packed ready for transfer into the customs territory. This clarification is designed to prevent any confusion regarding the limitation of "processing" to exclude those general and other expenses described above from the scope of the amendment.

The same commenter noted that it would be appropriate to apply the amendment to all affected entries on which "appraisement" (liquidation) had not become final on the effective date of the amendment. Customs agrees, finding that suggestion to be consistent with the intent of the proposal and sound Customs administration.

MERCHANDISE SUBJECT TO AMENDMENT

This amendment will apply to merchandise as to which liquidation has not become final on the effective date of the amendment.

INAPPLICABILITY OF E.O. 12044

This document is not subject to the Treasury Department directive implementing Executive Order 12044, "Improving Government Regulations", because the regulation was in process before May 22, 1978, the effective date of the directive.

DRAFTING INFORMATION

The principal author of this document was Todd J. Schneider, Regulations and Research Division, Office of Regulations and Rulings, U.S. Customs Service. However, personnel from other Customs offices participated in its development.

AMENDMENT TO THE REGULATIONS

Section 146.48(e), Customs Regulations (19 CFR 146.48(e)), is amended as set forth below:

PART 146 - FOREIGN-TRADE ZONES

Section 146.48(e) is amended to read as follows:

146.48 Treatment of merchandise not elsewhere provided for in this subpart.

*   *   *   *   *

(e) <u>Appraisement and tariff classification</u>. (1) Merchandise subject to the provisions of this section, upon transfer from a zone and entry for consumption or for warehousing, either immediately or after transportation in bond, shall be subject to appraisement and tariff classification in accordance with its character and condition at the time of its constructive transfer to the customs territory and, except for any different rates applicable to any privileged foreign merchandise therein, to the rate or rates of duty and tax in force at the time entry for consumption or withdrawal from warehouse for consumption is made (see sections 141.68 and 141.69 of this chapter).

(2) The value of the merchandise described in paragraph (e)(1) shall be determined in accordance with sections 402, 402a, and 500, Tariff Act of 1930, as amended (19 U.S.C. 1401a, 1402, 1500), and the related provisions of law. However, the cost of fabrication or other processing, and the general expenses and profit, related to zone operations shall be excluded when determining the dutiable value of an article produced entirely from nonprivileged merchandise (foreign or domestic), or from a combination of privileged and nonprivileged merchandise (foreign or domestic). All other expenses incurred in the

zone incidental to placing the article in condition, packed ready for transfer, and freight, insurance, and similar costs incurred after the article is packed ready for transfer into the customs territory also shall be excluded in determining dutiable value.

Acting Commissioner of Customs

FEB 4 1980

Approved

(Signed) Richard J. Davis

Assistant Secretary of the Treasury

Department of the TREASURY NEWS
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STATEMENT OF
DANIEL I. HALPERIN
DEPUTY ASSISTANT SECRETARY (TAX LEGISLATION)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON WAYS AND MEANS
March 19, 1980

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to present the views of the Department of the Treasury on the income tax provisions of H.R. 4769, "The Omnibus Maritime Regulatory Reform, Revitalization, and Reorganization Act of 1979."

The bill before us today has been substantially changed from the original version, on which we testified last fall before the Merchant Marine Subcommittee of the Committee on Merchant Marine and Fisheries. (A copy of our earlier testimony is attached hereto.) As originally drafted, H.R. 4769 proposed far-reaching changes in the treatment of international shipping income, including changes affecting the statutory reciprocal exemption, treaty exemptions, source rules, subpart F deferral and a new alternative tax on the shipping income of foreigners. Many of these proposals drew on the recommendations of the Task Force on Foreign Source Income, chaired by Congressman Rostenkowski, which submitted its report to this Committee on March 8, 1977.

Most of the proposals concerning international shipping income have now been eliminated from H.R. 4769; the provisions which have been retained primarily affect domestic shipping operations. I will comment on these specific provisions in a moment.

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First, however, we believe it is important to point out that the economics of international shipping is a complex matter, and that the treatment of domestic shipping operations is intimately related to the treatment of foreign-owned operations, including those foreign shipping companies controlled by U.S. companies. The Rostenkowski Task Force considered these complex matters and proposed certain changes in our treatment of the U.S. income derived by foreign shippers, such as limiting the statutory reciprocal exemption. We would respectfully suggest that the Committee examine the tax proposals of H.R. 4769 in an overall context of the appropriate taxation of the shipping industry, and we would be happy to work with the Committee in this effort.

H.R. 4769 contains a number of non-tax related provisions (i.e., Titles I, II, III and V) for revitalizing maritime policy. These non-tax provisions are not dependent upon the tax provisions (i.e., Title IV) and could proceed in the Congress on their own. This Committee could then devote careful attention to the whole area of shipping -- both domestic and international.

Let me now turn to the specific proposals before us today.

Section 401 of the bill amends the capital construction fund provisions of the Merchant Marine Act in two significant ways.

The Merchant Marine Act of 1936 (Section 607) now provides an income tax deferral for profits from certain "eligible vessels," if those profits are deposited in a capital construction fund. The deposited profits, and any earnings thereon, continue to be exempt from tax if they are withdrawn from the fund and used for the construction or reconstruction of certain types of "qualified vessels."

The bill expands the categories of "eligible vessels" and of "qualified vessels."

Under existing law, "eligible vessels" -- whose profits may be tax deferred -- must be U.S.-controlled, U.S. flag vessels which were constructed in the U.S. and which are operated only in the foreign or domestic commerce of the U.S. The bill would expand the deferral to include (1) profits from U.S.-controlled foreign flag ships, as well as U.S. flag ships, (2) profits from ships constructed outside, as well as in, the U.S. and (3) profits from international trade, as well as U.S. domestic and foreign trade.

The expansion of the "eligible vessels" category would provide U.S.-controlled foreign shipping corporations with a new, alternative form of tax deferral on their foreign earnings. Since such corporations may currently defer tax under subpart F by reinvesting earnings in vessels used abroad, we do not object on tax policy grounds to providing this alternative deferral, although we would wish to re-examine this issue in the context of an overall review of the tax treatment of shipping. While we defer to others more expert on these matters, we wish to point out that this new deferral option may not have any significant impact. In order to withdraw and use tax-deferred construction funds, U.S.-controlled foreign shipping companies must use U.S. flag ships and largely U.S. crews. Non-tax factors, especially labor costs and to some extent regulation of safety and operating standards, may therefore tend to make this deferral mechanism less attractive than that already available under subpart F. Moreover, there seems to be no shortage of capital construction funds. Accordingly, strengthening of U.S. shipyards may not be a likely result.

We would, however, object to the creation of an entirely new form of tax deferral by permitting the use of capital construction funds by domestic companies which have foreign-flagged and foreign-built vessels. Domestic operators already pay little or no U.S. tax, and creating additional tax subsidies will only encourage tax shelter abuses.

Also under existing law, "qualified vessels" -- i.e., those which may be constructed from tax deferred capital construction funds -- must be U.S.-controlled, U.S. flag vessels constructed in the U.S. and must be operated only in the U.S. foreign, Great Lakes or noncontiguous domestic trade. The bill would expand the category of "qualified vessels" to include ships built and flagged in the U.S., but operated in international trade and in the U.S. coastwise and intercoastal domestic trade -- i.e., essentially in all aspects of U.S. domestic and foreign commerce, except domestic trade in U.S. inland and intercoastal waters.

We do not see the reason for allowing capital construction funds to be used to build vessels for the U.S. coastal and intercoastal domestic trade, where domestic operators are already protected from foreign competition by the cabotage laws under the Jones Act. The main purpose of the capital construction funds was to equalize the tax treatment of U.S. and foreign ship operators in the U.S. foreign trade, not to provide a non-budgeted subsidy to domestic operators.

Section 402 of the bill amends the Internal Revenue Code in two significant ways.

First, the bill increases the available investment credit for ships built with tax-deferred capital construction funds from a maximum of 5% to 10%.

In 1976, Congress considered whether shippers should be given tax-deferral plus the full investment credit on new ships. Congress then decided to provide 50% of the applicable tax credit, but to allow the courts to decide whether the remaining 50% of the credit was already provided by pre-existing law. Congress expressly provided that taxpayers must inform the Internal Revenue Service on their tax returns that they are claiming the entire 10% credit, so that the Service and the taxpayer can litigate the issue in court. Some companies have successfully sued in court to obtain the full credit. Other cases are now in the process of litigation.

The Treasury Department strongly opposes this provision of the bill. When a ship is purchased with tax-deferred construction funds, the Federal Government has in effect provided a 46% reduction in the cost of the investment, compared to only 10% for other investors. This is so because reinvestment in capital construction funds means shippers have an effective tax deferral indefinitely. Allowing half of the investment credit reduces the cost of investing in ships by 51% compared to 10% for other investments. It is our position that even with no investment credit our tax law strongly favors investment in U.S. shipping assets over other types of investment; as noted above, U.S. shipowners in the aggregate pay little or no U.S. tax. We cannot support widening that tax preference still further.

In addition, providing an increased credit will have two very undesirable effects. First, since most shipowners already pay little or no U.S. tax, the increased credit will provide a "negative tax" and lead to tax shelter abuses. Second, shipowners who otherwise might avoid tax through use of capital construction funds (which must be used to build ships in the U.S.) may instead use the credit to shelter income. U.S. shipyards, who presumably are indirectly assisted by capital construction funds, will hardly benefit.

Second, the bill permits foreign-built vessels to be depreciated over 10 years and U.S.-built vessels over 5 years.

Current law already provides generous accelerated depreciation of capital expenditures for ships. Half the cost of a new ship can be written off by the fifth year and 75% by the eighth year.

We must oppose increasing the acceleration of depreciation deductions for ships. In many cases, such acceleration would reduce the U.S. tax on shipping income below zero, thus creating a "negative tax" and tax shelters for other taxpayers and other types of income. Once again, shippers who might otherwise avoid tax through use of capital construction funds might not need to do so as a result of the proposed accelerated depreciation deductions.

As you know, we are not in principle opposed to a new look at depreciation generally. However, now is not the time to provide unneeded assistance to only one segment of our economy. Our priority now is to balance the budget. Once this has been achieved, we can then provide tax relief where effective to encourage investment.

That concludes my statement. I would be happy to answer any questions.

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REMARKS BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
AMERICAN ARAB ASSOCIATION FOR COMMERCE & INDUSTRY
NEW YORK, NEW YORK

U.S.- SAUDI ECONOMIC INTERESTS

INTRODUCTION

There are few areas in the world where as many compelling American interests intersect as in the Middle East. With each passing month, the region seems to take on increasing significance. I would like to focus my remarks today on one country in this critical area -- Saudi Arabia.

Three years ago during Crown Prince Fahd's visit to the United States, President Carter said, "I think it is accurate to say that the future of Saudi Arabia and the future of the United States are tied together very closely in an irrevocable way. It is very valuable to us to understand, to preserve, and to strengthen this important friendship."

There are many important aspects to the United States-Saudi relationship. Energy and finance are key elements, with considerable impact not only on our own economies but on the entire world. Trade in non-energy products is becoming increasingly important, as well. The United States-Saudi Joint Economic Commission offers a third facet of our economic relations which is important to Saudi economic development and our continued close cooperation in the future.

I would like to touch on our mutual interests in energy, finance and trade, and then talk in some detail about the ongoing work of the Joint Commission.

ENERGY/FINANCE

Oil is the historic basis of the United States-Saudi Arabian relationship. Saudi Arabia's supplies of energy are crucial to the United States and world economies. Without sufficient petroleum at reasonable prices, stable non-inflationary growth becomes very difficult to achieve. Saudi Arabia is now the leading supplier of oil to the United States accounting for almost 20 percent of our imports. It also accounts for 19 percent of free world crude oil production.

The United States and Saudi Arabia have mutual interests in three key areas: investments, energy conservation and the security of oil supplies. First, because its oil income has exceeded its revenue needs, Saudi Arabia has accumulated substantial financial resources for which it has sought appropriate investment opportunities. The United States has been and continues to be the single largest recipient of Saudi investments. Most of Saudi Arabia's non-U.S. investments are also dollar-denominated. The strength of the dollar thus depends importantly on Saudi management of their surpluses. In turn, the value of Saudi investments depends on a strong and stable dollar.

A second interdependence relates to Saudi oil production and U.S. energy consumption. Since Saudi Arabia would prefer to limit oil production, it is interested in implementation of a U.S. energy program which emphasizes both conservation and the development of alternate energy resources. Saudi spokesmen in fact have linked price moderation on their part to conservation on our part.

Third, as the world's largest oil supplier, Saudi Arabia's security is vital to the United States and other consumers. Any disruption to Saudi oil supplies would have major adverse effects on us, as well as on Saudi Arabia itself.

These issues are intimately linked but I believe oil supplies and price, petrodollars, and the dollar are of most interest to this group.

OIL SUPPLY AND PRICE

On the supply side, Saudi Arabia has the world's largest proved reserves of petroleum (roughly 20 percent of the world's total) and possesses the capacity to become the world's largest oil producer. In the past, it has clearly been the dominant force within OPEC. While the sheer size of its oil reserves and production are important, a major source of its political power within OPEC has been its ability to vary oil production over a very wide range. Because of its lower revenue needs relative to its export earnings, it was able to reduce production to avoid intra-OPEC competition for market shares at times when supplies were slack. On the other hand, because of its considerable excess production capacity, it was capable of increasing its supplies to the oil market if other producers sought to raise prices above levels it believed appropriate.

The results of the Iranian crisis and the Caracus meeting last December are clear indications, however, that at least one of the major conditions for Saudi price leadership within OPEC is disappearing. With very little spare capacity available, Saudi Arabia has been less influential than in the past in moderating OPEC pricing decisions. Similarly, it was not able to fill the gap in supply caused by the loss of 4.5 to 5.0 mmb/d of Iranian exports in the early part of 1979.

Nevertheless, Saudi Arabia has played a most helpful role during the last year. For example, it increased production in late 1978 to the maximum sustainable capacity of over 10 mmb/d, and to 9.5 mmb/d during four of the last five quarters -- the latter being 1 mmb/d above the normal Saudi production ceiling. Similarly, on the price side, Saudi Arabia alone is charging the lowest price, $26 per barrel, for its Arabian light crude, the traditional OPEC benchmark. We hope that Saudi Arabia will continue to display this strong sense of reasonableness towards the international economy with respect to both oil supply and price.

We assume the Saudis will be considering substantial investments in new productive capacity if they are to continue to play a restraining role within OPEC. Saudi intentions in this area are not completely clear, but on a sustainable basis their current target appears to be 12 mmb/d. The main obstacle has been self-imposed investment constraints. Saudi Arabia is requiring that all investment by Aramco to maintain or expand productive capacity be derived from internally generated funds. Before the recent price increases, it appeared that this would delay attainment of the 12 mmb/d target, but the additional revenues now foreseen may change this situation. In any event, the year 1984 has recently been mentioned by several Saudi spokesmen for attainment of this target.

The Saudis can be expected to take a number of considerations into account in deciding how to implement the present target and whether to expand the target further.

Some of these are political, but a number are economic:

-- Substantial investment funds are required merely to maintain existing capacity, as is the case with any aging oil fields;

-- Additional investments would be required to expand capacity;

-- The Saudis are giving high priority to other investments: refining, petrochemicals, modernization more broadly;

-- There is growing concern in Saudi Arabia about producing oil at levels in excess of current income needs;

-- Many also argue that oil in the ground is a better investment than financial assets abroad.

The situation, thus, is as follows:

-- The Saudis have played a constructive leadership role in OPEC. They have normally attempted to moderate OPEC price increases and help assure the supplies needed for world economic health.

-- Continuation of a Saudi leadership role requires substantial investments so as to create sufficient excess capacity.

-- Some Saudis are doubtful that this is in their interest, particularly since they have seen consuming countries like the United States as slow to take the steps necessary to conserve oil use.

-- The Saudi position to date, however, has recognized that Saudi production levels must take into account the economic health and political stability of the free world.

There is much the United States and other oil consuming nations can do to sustain this sense of international responsibility. It is also important to continue the bilateral dialogue which to date has been profitable to both countries, and attempt to find a resolution of any real differences between us.

SAUDI INVESTMENTS

The other side of the coin to expanding Saudi oil production -- above that needed for its own internal development -- is the need for attractive investment opportunities.

Saudi Arabia has run large current account surpluses, totaling almost $80 billion since 1974. The size of the surplus has declined since the extraordinary $23 billion in 1974, as Saudi Arabia's ambitious development program has taken hold. However, the recent oil price increases have lead to a reversal of this trend. We expect Saudi Arabia to run substantial surpluses in the near term.

The Saudi Arabian Government has been most explicit in detailing the approach it takes toward investments. The Saudis have stated that they seek to play a constructive role, recognizing the need to act with larger issues in mind than solely their own profit. In this regard, they have avoided speculative transactions and investment in such sensitive areas as real estate or controlling interests in U.S. firms. According to Governor Quraishi, head of the Saudi Arabian Monetary Agency, their investment managers in this country have been instructed that at no time may Saudi investments reach 5 percent of the voting stock of any company. He has further indicated that their holdings of U.S. Government securities constitute the largest single component of their international reserves.

It is also evident that Saudi Arabia views its investments as crucial for its future and believes they will have to be increasingly employed to finance domestic development as oil reserves decline. Accordingly, the Saudis have followed a conservative investment policy with emphasis on income, security and liquidity.

Fulfillment of such a policy is not an easy task, however. Very few markets offer the Saudis sufficient liqudity and choice of investment opportunities, combined with minimal sovereign, exchange rate and convertibility risks. The U.S. capital market, and the closely related Eurodollar market, are easily the largest, broadest, most liquid, and most accessible. Thus, it is not surprising that Saudi Arabia has chosen to invest around 85 percent of its funds in the United States and in deposits in the Eurobanking market, the bulk of which are in dollars. We hope it will continue to do so.

U.S. ENERGY/INFLATION PROGRAMS

From its own perspective, Saudi Arabia clearly has a keen interest in U.S. domestic policy efforts to develop a comprehensive energy program and to effectively fight inflation. The United States has recently taken a number of steps toward comprehensive programs in both of these key areas. I would like to discuss them briefly.

In the energy area, the President's decision to decontrol domestic oil prices was a critically important step, complemented by the numerous other measures we have taken to cut domestic demand: mandatory automobile mileage standards, mandatory thermostat settings, switching from oil to gas, savings in federal government operations, changed environmental regulations, and appeals to voluntary conservation. The President has established ceilings for net oil imports of 8.2 mmb/d in 1979 and 1980 -- 300,000 below the actual 1978 level - and has indicated he is prepared to lower this ceiling further if other oil consuming countries will join in mutual reductions.

To stimulate production of alternatives to imported oil from our domestic energy resources, the President has proposed a Synthetic Fuels Corporation to encourage the production of synthetic fuels. He has proposed the creation of an Energy Mobilization Board to minimize delays in reviews of the construction of energy projects of major national interest, consistent with safeguarding the environment. The House of Representatives has passed a windfall profits tax which will provide additional funds for developing alternative energy sources, a similar bill has now gone to the Senate floor.

Finally, new targets have been established for nationwide gasoline consumption through agreement with the State Governors. This will result in savings of about 400,000 gallons per day, roughly a 5.5 percent decrease from average U.S. daily consumption in 1979. Last Friday the President also announced the imposition of a gasoline conservation fee on imported oil of $4.62 per barrel, which will be applied solely to gasoline in an amount equal to about 10 cents a gallon. This should reduce U.S. gasoline consumption by 100,000 barrels per day after one year. The President also will send to Congress legislation establishing a motor fuels tax designed to replace this gasoline conservation fee.

These measures represent a strong U.S. effort to achieve a comprehensive energy program to both increase domestic energy production and curb U.S. energy consumption, in recognition of our own responsibilities in this key area.

Last Friday the President also announced a major new anti-inflation program. In addition to the energy conservation measures I have already summarized, this program includes:

(1) Stringent efforts to achieve a balanced budget in FY 1981 through reductions in virtually every area of the budget not essential to our national security; direct expenditure cuts for government personnel, operations, and maintenance; a freeze in Federal civilian employment, aiming at an overall reduction of 20,000 employees by the end of 1980; a reduction in ongoing spending programs; increased Defense Department efficiencies to offset a large part of its cost increases; intensified pay and price monitoring; and proposed legislation to permit withholding of taxes on interest and dividend payments;

(2) authorization for new restraints on the growth of credit including consumer loans; restraint on large non-member banks and money market mutual funds; voluntary restraint on excessive growth in loans by large banks and other lenders; a surcharge of 3 percent on borrowing by large banks at the discount window; and a $4 billion cut in Federal loans and loan guarantees in FY 1981;

(3) Long-term economic structural changes including renewed appeal to Congress to deregulate the banking, trucking, railroad and communications industries and to lift the ceiling on returns for small savers, and tax measures to spur productivity once the budget is balanced and overall fiscal discipline is achieved.

These strong and decisive measures on both inflation and energy should carry the United States a substantial way toward meeting our major priorities of reducing inflation, adjusting to higher energy prices, reducing our vulnerability to OPEC price and supply decisions, and improving the efficiency and productivity of our economy. They should be most welcome to Saudi Arabia and, indeed, all countries which have a vital stake in the stability of both our own economy and that of the world as a whole.

COMMERCIAL TIES

The Saudis have also been using their oil revenues to import ever increasing quantities of goods and services. Total Saudi imports have grown from $2 billion in 1973 to around $24 billion in 1979. The United States has captured the largest share of the Saudi market in recent years, usually over 20%. United States exports to Saudi Arabia have increased dramatically, from $400 million in 1973 to $4.9 billion in 1979. Saudi Arabia has become the United States' seventh largest export market. In terms of two-way trade, Saudi Arabia is also our seventh largest trading partner.

Continued strong growth in U.S. exports to Saudi Arabia is anticipated in the future, despite active European and Asian competition. U.S. exports to Saudi Arabia reflect the technological superiority of U.S. products and U.S. responsiveness to Saudi needs. However, this favored position is dependent upon U.S. goods remaining cost competitive since there are few areas in which alternatives to American technology are not available. In addition, Saudi Arabia is increasingly cost-conscious as it seeks to maximize the developmental impact of its oil earnings.

In addition to mechandise trade, United States business involvement in the Kingdom includes an estimated $1 billion in service transfers such as architectural, consulting, engineering and construction services which affect all phases of Saudi development programs. For example:

-- U.S. companies prepared the master plans for major industrial complexes at Jubail and Yanbu and are managing construction of these projects.

-- U.S. firms designed huge new airports at Jidda, Riyadh and Dhahran/Jubail and are managing construction at the first two.

-- U.S. firms are involved in city planning at Jidda and Dammam, sewer construction in Jidda and the transpeninsular crude oil pipeline from the oil fields to Yanbu.

Over 400 U.S. firms currently have offices in the Kingdom. Over 30,000 Americans are living in Saudi Arabia, as testimony to U.S. industry's involvement. We want to encourage and expand U.S.-Saudi commercial ties, with mutual benefits for both the United States and Saudi Arabia. The Saudis are particularly interested in using more small and medium sized American firms as joint venture partners. This is an area on which your group may wish to focus.

The United States has taken a number of practical steps to expand its commercial ties with Saudi Arabia. In 1978, the President signed into law amendments to the Internal Revenue Code concerning the tax treatment of Amercians working overseas. These amendments afford qualified U.S. taxpayers living in Saudi Arabia, as well as in other foreign countries, heretofore unavailable deductions for the costs associated with living overseas. An additional $5,000 deduction is allowed to Americans living in Saudi Arabia and other hardship posts. In addition, the amendments restored the $20,000 exclusion for construction personnel and others living in work camps in Saudi Arabia and other hardship posts. Although the definitions relating to work camps were somewhat restrictive when initially proposed, those definitions have been substantially liberalized so the American employees living in typical Saudi Arabian work camps will be able to claim the $20,000 deduction.

In the area of U.S. anti-boycott laws, we are continuing our efforts to minimize the negative trade consequences of enforcing the law. Quite obviously, the anti-boycott provisions contained in the Internal Revenue Code and the Export Administration Act are not entirely consistent with an expanding U.S.-Saudi trading relationship. Nonetheless, the United States has been anxious to accommodate Saudi policies and practices in this area within the limits of U.S. law.

We hope the U.S. will maintain and, hopefully, expand its share of the Saudi market. A possible means of achieving this may be through more frequent dialogue between American and Arab businessmen perhaps using organizations such as this one. You and your colleagues may want to give some thought to ways of strengthening our commercial ties with the Arab world.

THE JOINT ECONOMIC COMMISSION

I would now like to discuss another important aspect of our overall relationship -- the U.S.-Saudi Joint Economic Commission. This subject is particularly timely because the fifth annual meeting of the Commission will take place in Washington on April 1st and 2nd with Secretary Miller and Saudi Finance Minister Abalkhail heading up the respective delegations.

The Commission has been in existence for almost six years. The traumatic events of the fall of 1973 -- the Yom Kippur War and the oil embargo -- obviously did not create economic interdependence but they did serve to highlight the fact of international interdependence. During the following year the United Satess established a series of Joint Commissions with Egypt, Jordan, Saudi Arabia and others. These were conscious efforts to strengthen political and economic - primarily economic-ties with countries of the Middle East region. The Joint Statement issued by Crown Prince Fahd and former Secretary of State Kissinger in 1974 expressed the mutual desire of Saudi Arabia and the United States to work together to "promote programs of industrialization, trade, manpower training, agriculture, and science and technology." Since that time, the Joint Commission has become an active mechanism to bring together the expertise of various parts of the U.S. and Saudi Arabian governments and their respective private sectors to pursue Saudi development goals.

Structurally, the Joint Commission has a system of parallel direction in which Secretary of the Treasury Miller and Minister of Finance and National Economy Mohammed Abalkhail serve as co-chairmen, and Dr. Mansoor Al Turki and I serve as coordinators. All U.S. project personnel have counterparts from Saudi Government agencies.

In order to support and coordinate Joint Commission work on the U.S. side, the Treasury Department established an Office of Saudi Arabian Affairs in Washington, and later an office of the U.S. Representation to the Joint Commission in Riyadh.

Technical cooperation programs under the Joint Commission are provided by the United States to the Saudi Arabian Government on a cost-reimbursable basis in accordance with a technical cooperation agreement initially signed early in 1975. During Secretary Miller's visit to Riyadh last November, this agreement was formally extended for another five year period. Projects are financed by drawing against a Saudi Arabian Trust Account which is held by the U.S. Treasury Department. United States specialists work side-by-side with Saudi counterparts on a multi-year basis in the various ministries and agencies. More than 150 of these specialists are now in Saudi Arabia.

To date, agreement has been reached on 20 major projects which cover a broad range of economic activities and which have a total ultimate value in excess of $750 million. Projects are being carried out in areas as diverse as vocational training and highway transportation. They share a common goal: the expansion of the Saudi Government's capability to plan, guide, and monitor its development effort.

I would like to focus on three project areas which offer major developmental benefits to Saudi Arabia: an electrification plan, cooperation in solar power development and the building of vocational training centers through the Kingdom.

POWERGRID PROJECT

One of the most significant tasks we have been asked by the Saudis to undertake, under the auspices of the Joint Commission, is the development of an Electrification Plan for the Kingdom which will cover the next 25 years. Saudi hopes for establishing a strong, relatively diverse economic base hinge directly on their ability to provide electrical power in adequate amounts in a cost-effective manner. And, by making electricity available to every Saudi, regardless of his station or location, the Goverment is able to demonstrate its interest and concern for the well being of the populace.

When Minister Ghazi Al-Gosaibi of the Ministry of Industry and Electricity approached the Joint Commission to undertake this project, he stated that his goal was to "bring electricity into every home in the Kingdom." The enormity of that task can be realized only when we recognize that there has been no similar effort -- on such a scale -- anywhere in the world before. Saudi Arabia is a country about a third the size of the United States, and many of its people are sparsely settled in small villages and towns scattered over much of the countryside.

Through this plan, the Saudis are trying to do in 25 years what it took us to accomplish in this country in over 75. The plan calls for a nearly forty-fold increase in the generating capacity of the Saudi power industry. Demand is increasing at a rate of about 25 percent a year, compared to an annual increase of about five percent in the United States since 1973. The capital cost for the new generating, transmission and distribution facilities over the life of the plan will be over $70 billion when figured with a 7 percent annual inflation rate. Such an incredible expenditure will provide the Saudis with an electrification system about equal to what we enjoy in this country today.

SOLERAS

A second major program involves U.S.-Saudi cooperation for solar energy development. This unique agreement is a jointly funded program under the auspices of the Joint Commission. Over the next five years, both the United States and Saudi Arabia will provide $50 million to the $100 million program agreement.

The first projects will include the design and installation of the world's largest solar photovoltaic electrical system for two existing villages about 50 kilometers from Riyadh. The villages are not reached by the national power grid. Household appliances, street lighting and agricultural water pumps, now serviced by diesel generators, will be powered by this solar energy system.

In time, this $12 million solar village project could serve as the prototype for rural electric development in Saudi Arabia and other developing countries. The United States, the leader in photovoltaic cell manufacturing, could reap major benefits through the marketing of this sophisticated new technology.

Other projects expected to be initiated under the Solar Agreement this year include an engineering test of a large sun powered air conditioner mounted on a commercial building in the United States. We also are planning projects to study the socio-economic effects of the solar system on the two villages and the establishment of solar insulation measuring stations at several sites in Saudi Arabia. Discussion will begin soon also for the testing of solar air conditioners in Saudi Arabia, and the design and construction in the United States of a solar desalination device.

This exciting, innovative area of cooperation under the Joint Commssion directly involves the U.S. Department of Energy and the Saudi Arabian National Center for Science and Technology, and the U.S. Treasury and the Saudi Ministry of Finance. The Solar Energy Research Institute, which is the national center for solar development in the United States, serves as the secretariat and program manager for the Agreement.

The U.S.-Saudi Solar Agreement is a practical statement about the need to reach quickly into the future for clean, economic, renewable technologies to provide energy for future generations. It is also one more manifestation of close collaboration between the United States and Saudi Arabia.

Aside from making a very real contribution to the advancement of solar technology, the SOLERAS agreement testifie to the importance Saudi Arabia places on the development of alternative energy resources and on encouraging energy conservation in general. This solar energy program mates the world's largest exporter of petroleum with the world's largest importer of petroleum. While it would be overly sanguine for us to expect major technological breakthroughs under the US-Saudi Solar Energy Program, we believe that this cooperative effort will contribute substantially to stimulatin research and development and could result in longterm payoffs in developing solar powered alternatives to petroleum. We are especially pleased that the solar energy program includes educational exchanges and training programs for U.S. and Saudi students.

VOTRAKON

Vocational training is the largest of the Joint Commission projects, both in terms of anticipated total costs and in terms of numbers of Americans who are living in Saudi Arabia and working on the project. A lack of skilled manpower is widely acknowledged as one of the major obstacles to smooth and rapid development of the Kingdom and the first Five Year Development Plan identified man-power development and training as one of the Kingdom's highest priority needs.

The VOTRAKON project is designed to increase both the number and skills of Saudi craftsmen through systematic strengthening of vocational training curricula and construction of additional training facilities. Work is well underway in the areas of machine shop trades, automotive repair, welding, diesel engine repair, air conditioning repair and refrigeration, electricity and plumbing. Saudi Arabians will be trained in developing and using instructional materials incorporating the most modern techniques and equipment. High priority is also being given to building an effective on-the-job training program throughout the Kingdom.

Saudi and U.S. project personnel are working together to strengthen the administration of training programs, to establish an instructor training institute and an instructional materials development center. Labor market analysts are continually gathering and analyzing statistical information to assist the Ministry of Labor and Social Affairs in planning and managing all these training activities.

To expand the capacity of the Ministry's vocational training system, the U.S. Department of Labor and the General Services Administration are heavily involved in the design anc construction of the new Instructor Training Institute as well as ten new training facilities and housing for both students and instructors at fifteen existing training sites.

As part of the overall project effort, a competitive plan is being prepared to expand an existing effort in the United States for preparing Saudi administrators and instructors for their jobs in the new training system. It is estimated that over 300 Saudi personnel may be trained here in the United States as part of this project.

CONCLUSION

I have emphasized the significance of U.S. interests vis-a-vis Saudi Arabia in the areas of oil, finance, commerce and bilateral cooperation characterized by the Joint Economic Commission. The Joint Commission symbolizes the close relationship between the United States and Saudi Arabia, and has emerged in its own right as an important vehicle for bilateral technical cooperation. The Commission work does not by any means encompass all American involvement in Saudi development. In fact, the vast majority of trade is carried on outside the aegis of the Commission. As in any relationship, certain differences may occur from time to time -- hopefully, without imposing serious strains on the totality of that relationship. Our overall dealings with Saudi Arabia have been, and should continue to be, characterized by mutual understanding and confidence.

It is clear that Saudi Arabia, as the world's largest exporter of oil, and the United States, as the largest producer of goods and services, have interests which extend beyond our bilateral relationship to include a mutual desire for a strong global economy and world peace. For our part, the United States will continue to work diligently toward this objective in all the areas I have mentioned.

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

FOR RELEASE AT 4:00 P.M. March 18, 1980

TREASURY OFFERS $6,000 MILLION OF 37-DAY
CASH MANAGEMENT BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $6,000 million of 37-day Treasury bills to be issued March 25, 1980, representing an additional amount of bills dated November 1, 1979, maturing May 1, 1980 (CUSIP No. 912793 4C 7). Additional amounts of the bills may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

Competitive tenders will be received at all Federal Reserve Banks and Branches up to 12:30 p.m., Eastern Standard time, Thursday, March 20, 1980. Wire and telephone tenders may be received at the discretion of each Federal Reserve Bank or Branch. Each tender for the issue must be for a minimum amount of $1,000,000. Tenders over $1,000,000 must be in multiples of $1,000,000. The price on tenders offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Noncompetitive tenders from the public will not be accepted. Tenders will not be received at the Department of the Treasury, Washington.

The bills will be issued on a discount basis under competitive bidding, and at maturity their par amount will be payable without interest. The bills will be issued entirely in book-entry form in a minimum denomination of $10,000 and in any higher $5,000 multiple, on the records of the Federal Reserve Banks and Branches.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. 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.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch in cash or other immediately available funds on Tuesday, March 25, 1980.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, No. 418 (current revision), Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars may be obtained from any Federal Reserve Bank or Branch.

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

March 20, 1980

FOR RELEASE AT 10:00 a.m.

The Department of the Treasury announced today the following schedule of sales:

-- $4 billion of 359-day Treasury bills to refund $3.3 billion of bills maturing April 1, 1980 and to raise $.7 billion new cash. Tenders will be received up to 1:30 p.m., March 26, 1980.

-- $5 billion of 77-day Treasury bills to be issued on April 3, 1980, representing an additional amount of bills maturing June 19, 1980. Tenders will be received up to 1:30 p.m., March 27, 1980.

-- $1.5 billion of 15-year, 1-month bonds to be issued April 8, 1980, and to mature May 15, 1995. Tenders will be received up to 1:30 p.m., April 2, 1980.

The details of these offerings were provided in separate announcements.

The Treasury also announced its intention to auction on April 1, 1980 approximately $5 billion of 83-day Treasury bills to be issued April 4, 1980, representing an additional amount of bills maturing June 26, 1980. The actual amount of this sale will be announced March 27, 1980.

Treasury announced that these financings reflect somewhat increased cash needs due to foreign central bank redemptions of non-marketable securities as a result of the recent strength of the dollar, and also to continued large redemptions of savings bonds.

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

FOR RELEASE AT 10:00 A.M. March 20, 1980

TREASURY OFFERS $5,000 MILLION OF 77-DAY CASH MANAGEMENT BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $5,000 million of 77-day Treasury bills to be issued April 3, 1980, representing an additional amount of bills dated December 20, 1979, maturing June 19, 1980 (CUSIP No. 912793 4K 9). Additional amounts of the bills may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

Competitive tenders will be received at all Federal Reserve Banks and Branches up to 1:30 p.m., Eastern Standard time, Thursday, March 27, 1980. Wire and telephone tenders may be received at the discretion of each Federal Reserve Bank or Branch. Each tender for the issue must be for a minimum amount of $1,000,000. Tenders over $1,000,000 must be in multiples of $1,000,000. The price on tenders offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Noncompetitive tenders from the public will not be accepted. Tenders will not be received at the Department of the Treasury, Washington.

The bills will be issued on a discount basis under competitive bidding, and at maturity their par amount will be payable without interest. The bills will be issued entirely in book-entry form in a minimum denomination of $10,000 and in any higher $5,000 multiple, on the records of the Federal Reserve Banks and Branches.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. 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.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch in cash or other immediately available funds on Thursday, April 3, 1980.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, No. 418 (current revision), Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars may be obtained from any Federal Reserve Bank or Branch.

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

FOR RELEASE AT 10:00 A.M. March 20, 1980

TREASURY TO AUCTION $1,500 MILLION OF 15-YEAR 1-MONTH BONDS

The Department of the Treasury will auction $1,500 million of 15-year 1-month bonds to raise new cash. Additional amounts of the bonds may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

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

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Attachment

M-382

(over)

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 15-YEAR 1-MONTH BONDS
TO BE ISSUED APRIL 8, 1980

March 20, 1980

<u>Amount Offered</u>:	
To the public........................	$1,500 million
<u>Description of Security</u>:	
Term and type of security...........	15-year 1-month bonds
Series and CUSIP designation........	Bonds of 1995 (CUSIP No. 912810 CN 6)
Maturity date........................	May 15, 1995
Call date............................	No provision
Interest coupon rate.................	To be determined based on the average of accepted bids
Investment yield.....................	To be determined at auction
Premium or discount..................	To be determined after auction
Interest payment dates...............	November 15 and May 15 (first payment on November 15, 1980)
Minimum denomination available......	$1,000
<u>Terms of Sale</u>:	
Method of sale......................	Yield auction
Accrued interest payable by investor............................	None
Preferred allotment..................	Noncompetitive bid for $1,000,000 or less
Deposit requirement..................	5% of face amount
Deposit guarantee by designated institutions........................	Acceptable
<u>Key Dates</u>:	
Deadline for receipt of tenders.....	Wednesday, April 2, 1980, by 1:30 p.m., EST
Settlement date (final payment due)	
a) cash or Federal funds.......	Tuesday, April 8, 1980
b) check drawn on bank within FRB district where submitted...................	Friday, April 4, 1980
c) check drawn on bank outside FRB district where submitted...................	Friday, April 4, 1980
Delivery date for coupon securities.	Wednesday, April 16, 1980

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

FOR RELEASE AT 10:00 A.M. March 20, 1980

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $4,000 million, of 359-day Treasury bills to be dated April 1, 1980, and to mature March 26, 1981 (CUSIP No. 912793 5Z 5). This issue will provide about $650 million new cash for the Treasury as the maturing issue is outstanding in the amount of $3,346 million, including $470 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,074 million currently held by Federal Reserve Banks for their own account.

The bills will be issued for cash and in exchange for Treasury bills maturing April 1, 1980 . Tenders from Federal Reserve Banks for themselves and as agents for 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 for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. This series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Wednesday, March 26, 1980. 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.

M-383

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 April 1, 1980, in cash or other immediately available funds or in Treasury bills maturing April 1, 1980. 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 March 20, 1980

RESULTS OF TREASURY'S 37-DAY BILL AUCTION

Tenders for $6,004 million of 37-day Treasury bills to be issued on March 25, 1980, and to mature May 1, 1980, were accepted at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	98.384	15.723%	16.20%
Low -	98.281	16.725%	17.25%
Average -	98.343	16.122%	16.62%

Tenders at the low price were allotted 1%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICT:

Location	Received	Accepted
Boston	$ 27,000,000	$ 27,000,000
New York	7,575,000,000	5,130,000,000
Philadelphia	---	---
Cleveland	---	---
Richmond	3,000,000	3,000,000
Atlanta	---	---
Chicago	375,000,000	325,000,000
St. Louis	---	---
Minneapolis	10,000,000	10,000,000
Kansas City	---	---
Dallas	---	---
San Francisco	509,000,000	509,000,000
TOTAL	$8,499,000,000	$6,004,000,000

An additional $ 900 million of the bills will be issued to Federal Reserve Banks as agents of foreign and international monetary authorities for new cash.

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

FOR IMMEDIATE RELEASE March 20, 1980

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $3,500 million of $6,907 million of tenders received from the public for the 2-year notes, Series Q-1982, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	14.94% 1/
Highest yield	15.07%
Average yield	15.01%

The interest rate on the notes will be 15%. At the 15% rate, the above yields result in the following prices:

Low-yield price	100.101
High-yield price	99.883
Average-yield price	99.983

The $3,500 million of accepted tenders includes $819 million of noncompetitive tenders and $2,391 million of competitive tenders from private investors, including 15% of the amount of notes bid for at the high yield. It also includes $290 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 $3,500 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 March 31, 1980.

1/ Excepting 3 tenders totaling $115,000.

M-385

15% TREASURY NOTES OF SERIES Q-1982

DATE: 3-20-80

HIGHEST EVER ~~SINCE~~:

LAST ISSUE:
2/20/80
13 7/8 %   13.98% YIELD

LOWEST SINCE:

TODAY:
15%   15.01% YIELD

PREVIOUS HIGH

13 7/8 % FEBRUARY, 1980

epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
March 24, 1980

Contact: Robert E. Nipp
202/566-5328

U.S. - SAUDI ECONOMIC COMMISSION TO MEET AT THE TREASURY DEPARTMENT

The Fifth Session of the United States - Saudi Arabian Joint Commission on Economic Cooperation will be held April 1 and 2 at the Treasury Department to review the status and progress of 19 technical cooperation projects being carried out by the Commission and to discuss plans for the future activity of the Commission.

Secretary of the Treasury G. William Miller and the Saudi Arabian Minister of Finance and National Economy Muhammed Al-Ali Abalkhail are Co-Chairmen of the Commission.

Secretary Miller and Minister Abalkhail will open the meeting with introductory statements at 2:30 p.m. on April 1st. The closing plenary session on April 2 will include a review of Joint Commission Projects, concluding statements by the co-chairmen on the work of the Joint Commission and the issuance of a Joint Communique. This session will be followed by a press conference by Secretary Miller and Minister Abalkhail at 4:30 p.m., in the Treasury Cash Room.

Since the establishment of the Joint Commission on June 8, 1974, the two governments have launched a broad range of technical cooperation projects. The Joint Commission is served by a professional staff of about 180 in Riyadh, Saudi Arabia. Funding for the Commission's activities which is by the Saudi Arabian Government, has totalled $365 million.

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M-386

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

For Release Upon Delivery
Expected at 10:30 a.m.

STATEMENT OF DAVID J. SHAKOW
ASSOCIATE TAX LEGISLATIVE TAX COUNSEL
BEFORE THE
SUBCOMMITTEE ON SELECT REVENUE MEASURES
OF THE HOUSE COMMITTEE ON WAYS AND MEANS
March 24, 1980

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to present the views of the Treasury Department concerning six bills: H.R. 5716, H.R. 4155, H.R. 4725, H.R. 5124, H.R. 5968, and H.R. 4070.

H.R. 5716

H.R. 5716 would amend the special provisions governing the tax treatment of the ConRail re-organization. The bill would change the consolidated return rules as they apply to an affiliated group of corporations one of whose members participated in the ConRail reorganization.

Under the consolidated return rules, the losses of a subsidiary corporation generally are taken into account in calculating the income of an affiliated group. The regulations provide a mechanism to measure the losses of each corporation in the group that are used in calculating the group's taxable income for the year. Generally, the affiliated group is permitted to use losses from one corporation in excess of its investment in that corporation. However, if the total losses of a subsidiary that are used by the group exceed the group's investment in the subsidiary, those excess losses are taken into account in calculating the income realized on the disposition of the subsidiary's stock. For this purpose, if the stock of the subsidiary becomes worthless, a disposition is considered to have occurred, since it can be concluded at that point that the losses claimed by the group will permanently exceed out-of-pocket investment.

H.R. 5716 would alter the application of the normal consolidated return rules where the determination of the worthlessness of the subsidiary's stock depends on a determination of final value by the special ConRail court that is determining the value of assets transferred by the transferor railroads to ConRail. It provides that the stock of the transferor railroad cannot be considered worthless for purposes of the consolidated return rules in such circumstances before a determination of the special court becomes final. At present, it is not expected that a final decision in the ConRail valuation proceeding will be made for a number of years.

The issue touched upon in this bill affects particularly the consolidated return of the Norfolk and Western Railway for the year 1976. The Internal Revenue Service has taken the position that Norfolk and Western's stock holdings in the Erie Lackawanna Railway became worthless in 1976, thus triggering the excess loss account of the Norfolk and Western affiliated group in the Erie Lackawanna.

While the precise issue raised by the IRS in respect of Norfolk and Western's 1976 tax return is not the same as the issue raised in the ConRail valuation proceeding, we believe that many of the same issues would arise in both proceedings. Accordingly, we would not oppose legislation that would effectively hold in suspense the 1976 determination in respect of Norfolk and Western's tax return until the ConRail valuation proceeding becomes final. However, under such legislation, if the amount received in the ConRail proceeding were insufficient to give value to the Erie Lackawanna stock, it might well be appropriate for the excess loss account to be triggered as of 1976. Under H.R. 5716, a determination of worthlessness would not be made before the date on which the ConRail valuation court's determination becomes final. Thus, the difference between the legislation I have described and the bill before you, as a practical matter, appears to be the interest that would be owed on any tax that would finally be determined as due.

If H.R. 5716 is passed, it should not put the IRS in a worse position than it would be in if the excess loss account were triggered as of 1976 (except for the interest factor referred to before). Accordingly, it should be clear that the IRS can collect the tax on the excess loss account at some point. Presumably, the tax on the excess loss account should be collected no later than the year the Erie Lackawanna is removed from the Norfolk and Western consolidated return. Further, it should be made clear that no action subsequent to 1976 may be taken which would have the effect of preventing the tax consequences that would have resulted if the excess loss account had been triggered in 1976.

H.R. 4155

H.R. 4155 would permit the disclosure to the Commissioner of Education* of the mailing addresses of students who have defaulted on loans under the Migration and Refugee Assistance Act of 1962 (the Cuban Student Loan Program) solely for the purposes of locating the defaulting student for purposes of collecting the loan. Under current law, the mailing addresses of students who have defaulted on loans under the National Direct Student Loan Program may be disclosed to the Commissioner of Education who in turn may disclose the addresses to the educational institutions involved. The institution's officers, employees and agents may use the addresses to collect the defaulted loans.

We see no reason to draw a distinction between the two loan programs and therefore do not oppose enactment of H.R. 4155.

In addition, we would not oppose extending this limited disclosure authority to allow disclosures to lenders and State and non-profit guaranty agencies in regard to students who have defaulted on loans under the Guaranteed Student Loan Program, a separate program from the programs already mentioned. Extending the disclosure authority with respect to the Guaranteed Student Loan Program is supported by HEW.

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* Reference in the statute should now be to the Secretary of Education.

H.R. 4725

H.R. 4725 would eliminate one of the requirements under Code Section 7275(a) regarding certain airline tickets. Section 7275(a) now has two requirements with respect to airline tickets which are subject entirely to the eight percent excise tax imposed by Section 4261. First, the ticket is required to show the total of the amount paid for transportation and the amount of the Federal excise tax. Second, if the ticket shows the amount for transportation paid with respect to any segment of the transportation, the total of the amount paid for such segment and the tax relating to such segment must be shown. H.R. 4725 would repeal this separate segment rule in order to eliminate the clerical work involved in computing and adding the excise tax for segments.

The Treasury Department does not oppose the repeal of this requirement.

H.R. 5124

This bill would permit transfers of proven oil and gas properties to a controlled corporation, without the loss of percentage depletion, if the controlling shareholder elects to allocate his 1,000 barrels per day allowance for percentage depletion with the controlled corporation.

Under present law, certain independent producers and royalty owners are permitted a percentage depletion deduction on up to 1,000 barrels of oil or gas per day. Certain related parties are treated as one taxpayer and are required to share one 1,000 barrel per day allowance. Related parties are defined as component members of the same controlled group of corporations, businesses under common control, and members of the same family. An individual and a controlled corporation are not, however, related parties under current law. Thus, an individual and a controlled corporation each has a separate 1,000 barrel per day allowance for purposes of percentage depletion. An individual and a controlled corporation are therefore eligible for a percentage depletion deduction on as much as 2,000 barrels per day.

To prevent taxpayers with production in excess of 1,000 barrels a day from increasing aggregate percentage depletion deductions by transferring proven oil or gas properties to taxpayers with production of less than 1,000 barrels a day, present law generally provides that the transferee of a proven oil or gas property may not take percentage depletion with respect to that property. Among the exceptions to this general rule are transfers between related parties. Because related parties must share one 1,000 barrel per day allowance, transfers between related parties generally cannot increase the aggregate percentage depletion deductions within the related group. Because an individual and a controlled corporation are not related parties for this purpose, this exception does not apply to transfers between such parties and the transferee is not allowed a percentage depletion deduction with respect to the transferred property.

The bill would permit shareholders of a controlled corporation to elect to treat themselves and the corporation as related parties. An election would require a shareholder to allocate his 1,000 barrel per day allowance with the corporation and would thus permit transfers of proven properties by an individual to the controlled corporation without loss of percentage depletion.

The Treasury Department is not opposed to allowing a controlling shareholder to elect to allocate his 1,000 barrel per day allowance between himself and the corporation. There are, however, certain technical changes in the language of the bill that we believe should be made. Most of these changes have been incorporated in an amendment to H.R. 1212 which was reported by the Senate Finance Committee in December of 1979. We are confident that these changes can be worked out with the staff of the Committee.

H.R. 5968

Section 501(c)(9) of the Code exempts from tax associations of employees which provide life, sick, accident or other benefits to the members of the association, their dependents or their designated beneficiaries. H.R. 5968 specifically would allow such associations to provide permanent as well as term life insurance.

While the predecessor of section 501(c)(9) was enacted during the 1920's, the statute subsequently was modified several times and the first notice of proposed rulemaking was not published under section 501(c)(9) until 1969. Those regulations would have precluded the use of permanent life insurance contracts, limiting the provision of life benefits to term insurance. Because of controversy over various aspects of the first notice of proposed rulemaking the Treasury has not finalized the proposed regulations, but has instead been at work preparing a new notice of proposed rulemaking. It is anticipated that those proposed regulations, which should be promulgated before summer, will be far less controversial than the prior notice. There is no danger that the provision of life benefits involving permanent insurance contracts will cause the exemption of any section 501(c)(9) organization to be revoked before these regulations are published in final form. Therefore, we urge the Committee to delay action on H.R. 5968 until there has been adequate opportunity to review and consider the new proposed regulations.

The question raised by H.R. 5968 is, of course, under consideration in reviewing the new notice of proposed rulemaking. It is one of the more difficult remaining issues. While we have not reached a final resolution of the matter we can point out the basic considerations that are involved.

In the case of section 501(c)(9) trusts funded through deductible employer contributions, allowing a trust to utilize permanent life insurance contracts may create opportunities to provide deferred compensation through such trusts. There is an existing set of detailed rules regarding the provision of deferred compensation. In particular, in order for an employer to obtain a current deduction on funding without tax to employees, it is necessary to satisfy the conditions for qualified plans. Allowing section 501(c)(9) trusts to provide permanent benefits raises the possibility that such trusts could be used to undermine these rules.

To the best of our knowledge, the principal proponents of H.R. 5968 are not trusts that are funded with employer contributions, but rather associations from which members directly purchase insurance protection. Nevertheless, it should be recognized that H.R. 5968 draws no distinction between these two classes of organizations. Moreover, in the case of section

501(c)(9) trusts which in effect sell life insurance products to association members, who purchase them with tax-paid dollars, there are questions about how to draw the line between an exempt trust and a taxable life insurance company.

In reworking the regulations under section 501(c)(9) the Treasury has been endeavoring to fashion rules that would minimize the problems to which I have just adverted, while at the same time maintaining fidelity to the statutory purposes. As I have noted, we anticipate that these regulations should be promulgated within the next several months. And, as I also noted, there is no risk that any organization providing permanent life insurance benefits would be in jeopardy, if at all, until final regulations are promulgated. We therefore suggest that the Congress defer action on H.R. 5968.

H.R. 4070

H.R. 4070 would amend section 501(c)(19) of the Code, which provides an exemption from income tax for war veterans organizations. That section now requires that 75 percent of the membership consist of war veterans, and that substantially all of the balance of the membership consist of veterans (other than war veterans), cadets, and the spouses, widows and widowers of such persons. The bill would amend section 501(c)(19) to provide that 75 percent of the membership must consist of present or past members of the Armed Forces, with substantially all of the balance consisting of the other persons named above.

Section 501(c)(19) was added to the Code in 1972, together with a special amendment to section 512 concerning the taxation of unrelated business income. The latter provision, which excludes from the unrelated business income tax the income derived by a war veterans organization from certain insurance activities, was the basic reason for providing a separate exemption for war veterans organizations. Prior to 1972, war veterans organizations were usually recognized as exempt social clubs described in section 501(c)(7). One of the activities typically engaged in by such groups was the provision of insurance for their members at group rates. Prior to 1969, there was no tax on this insurance activity since the unrelated business income tax did not apply to social clubs. After 1969, the question was raised as to whether the income derived by veterans organizations from this activity should be subject to the unrelated business income tax. That question was resolved favorably to the veterans organizations by enactment of the amendments to sections 501 and 512, which provided a separate organizational exemption for war veterans organizations and excluded the insurance income from the unrelated business income tax as long as it was used either to provide for insurance benefits for members, or for charitable purposes.

As a result of this legislation, therefore, war veterans organizations, although essentially operated as social clubs for the benefit of their members, are treated more favorably than social clubs exempt under section 501(c)(7) in two respects. First, by reason of the special unrelated business income tax treatment for their insurance activities, amounts received in respect of these activities generally are not subject to the unrelated business income tax, even though, if carried on by other social clubs, the provision of such benefits might very well give rise to tax or, in some instances, to loss of exemption under section 501(c)(7). In addition, unlike social clubs exempt under section 501(c)(7), the passive investment income of war veterans organizations is exempt from tax, even though such income may be applied to defray personal recreational activities of the members of the organization with tax-free, rather than tax-paid dollars. In the case of social clubs exempt under section 501(c)(7), investment income is subject to tax unless set aside and then used for charitable purposes.

In view of the fact that, despite the essentially social nature of war veterans organizations, they are treated more favorably than other social clubs both in terms of investment income and in terms of income from the active conduct of an insurance business, we do not feel it would be appropriate to relax the qualifications for exemption under section 501(c)(19). There is no basis that we can see for doing so other than to widen the class of people who may participate in the use of war veterans organizations. Perhaps the rather generous statutory scheme that is available to organizations described in section 501(c)(19) is justifiable where it is limited to those who have been in combat in service of the country. We do not see why it should be extended to all who are, or have been, members of the Armed Forces.

The Treasury therefore opposes H.R. 4070.

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

FOR IMMEDIATE RELEASE March 24, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,401 million of 13-week bills and for $3,400 million of 26-week bills, both to be issued on March 27, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 26, 1980			:	26-week bills maturing September 25, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	95.862 a/	16.370%	17.31%	:	92.174	15.480%	17.03%
Low	95.803	16.604%	17.57%	:	91.936	15.951%	17.59%
Average	95.821	16.532%	17.49%	:	92.063	15.700%	17.29%

a/ Excepting 1 tender of $500,000

Tenders at the low price for the 13-week bills were allotted 42%.
Tenders at the low price for the 26-week bills were allotted 39%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 66,305	$ 66,305	:	$ 60,235	$ 60,235
New York	7,244,235	2,733,415	:	4,230,390	2,562,340
Philadelphia	42,325	38,795	:	25,675	25,675
Cleveland	95,620	64,460	:	29,010	29,010
Richmond	80,030	55,030	:	47,585	47,585
Atlanta	77,750	69,750	:	66,855	56,855
Chicago	400,425	77,315	:	307,035	187,035
St. Louis	51,780	26,865	:	42,665	25,665
Minneapolis	19,370	19,370	:	8,105	8,105
Kansas City	50,250	48,030	:	43,960	43,960
Dallas	25,425	25,425	:	13,500	13,500
San Francisco	360,380	120,380	:	355,825	265,575
Treasury	55,990	55,990	:	74,520	74,520
TOTALS	$8,569,885	$3,401,130	:	$5,305,360	$3,400,060
Type					
Competitive	$6,265,340	$1,096,585	:	$3,655,270	$1,749,970
Noncompetitive	1,016,995	1,016,995	:	680,025	680,025
Subtotal, Public	$7,282,335	$2,113,580	:	$4,335,295	$2,429,995
Federal Reserve	935,000	935,000	:	944,165	944,165
Foreign Official Institutions	352,550	352,550	:	25,900	25,900
TOTALS	$8,569,885	$3,401,130	:	$5,305,360	$3,400,060

1/Equivalent ~~coupon~~-issue yield.

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DATE: March 24, 1980

	13-WEEK	26-WEEK
TODAY:	16.532%	15.700 %
LAST WEEK:	15.053%	14.950 %
HIGHEST SINCE:		
3/10/80	15.381%	14.956%
LOWEST SINCE:		

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

FOR RELEASE AT 4:00 P.M.

March 25, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $6,800 million, to be issued April 3, 1980. This offering will provide $500 million of new cash for the Treasury as the maturing bills are outstanding in the amount of $6,306 million, including $515 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,746 million currently held by Federal Reserve Banks for their own account. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,400 million, representing an additional amount of bills dated January 3, 1980, and to mature July 3, 1980 (CUSIP No. 912793 4U 7), originally issued in the amount of $3,373 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,400 million to be dated April 3, 1980, and to mature October 2, 1980 (CUSIP No. 912793 5H 5).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing April 3, 1980. Tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the weighted average prices 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, March 31, 1980. 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 April 3, 1980, in cash or other immediately available funds or in Treasury bills maturing April 3, 1980. 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 March 25, 1980

RESULTS OF AUCTION OF 4-YEAR NOTES

The Department of the Treasury has accepted $2,500 million of $6,508 million of tenders received from the public for the 4-year notes, Series D-1984, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	14.20% 1/
Highest yield	14.33%
Average yield	14.29%

The interest rate on the notes will be 14-1/4%. At the 14-1/4% rate, the above yields result in the following prices:

Low-yield price	100.149
High-yield price	99.763
Average-yield price	99.881

The $2,500 million of accepted tenders includes $ 498 million of noncompetitive tenders and $1,693 million of competitive tenders from private investors, including 16% of the amount of notes bid for at the high yield. It also includes $309 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 $2,500 million of tenders accepted in the auction process, $309 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 March 31, 1980, and $ 66 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

1/ Excepting 1 tender of $5,000

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

FOR IMMEDIATE RELEASE
March 25, 1980

Contact: George G. Ross
202/566-2356

UNITED STATES AND UNITED KINGDOM
EXCHANGE INSTRUMENTS OF RATIFICATION
ON INCOME TAX TREATY

Instruments of ratification were exchanged in Washington, D.C. today with respect to the "Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains."

Secretary G. William Miller represented the United States, and Ambassador Sir Nicholas Henderson represented the United Kingdom at the exchange of instruments ceremony.

The exchange of instruments encompasses the Convention, which was signed on December 31, 1975 and its subsequent amendments which were effected by an exchange of notes signed on April 13, 1976 and by the Protocols signed on August 26, 1976, March 31, 1977 and March 15, 1979.

The income tax treaty, as amended by the exchange of notes and the three Protocols, will enter into force on April 25, 1980. It will have effect for most purposes for taxable periods beginning in 1975, except that for dividends paid by United Kingdom corporations to the United States portfolio investors, the effective date is April 6, 1973.

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

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M., EST
WEDNESDAY, MARCH 26, 1980

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STATEMENT BY THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON INTERNATIONAL
DEVELOPMENT INSTITUTIONS AND FINANCE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

Authorization Requests for the Multilateral Development Banks for 1980

Introduction

It is a pleasure, Mr. Chairman, to appear before you today to present the Administration's proposals for U.S. participation in the replenishment of resources of the International Development Association (IDA), for membership of the United States in the African Development Bank (AFDB) and subscriptions to that institution, and for changes in the budgetary and appropriations treatment of U.S. subscriptions to the callable capital of the World Bank (IBRD) and Asian Development Bank (ADB).

The 1979 Legislation

Before discussing this bill, I want to express the grave concern of the Administration over the substantial reductions in the last year's authorization bill for the regional banks, voted earlier this month by the House, despite recommendations by this Committee for authorization of the full amounts. Those cuts, consisting of $1.2 billion out of $3.4 billion requested

If the recent House action on the IDB were sustained, other donors would in all likelihood call for a renegotiation of the entire replenishment package. At the outset, this would force out over $2 billion in other donor contributions to the replenishment, because the IDB Charter does not permit the U.S. share to drop below the current threshold of 34.5 percent. Moreover, given the extremely favorable results of the IDB Fifth Replenishment, from U.S. policy and budgetary perspectives, a renegotiation would not be in the U.S. interest.

As part of the Fifth Replenishment package the United States achieved:

-- agreement that 50 percent of total Bank lending from this replenishment would directly benefit low income groups

-- a lowering of the share of paid-in capital from 10 percent to 7-1/2 percent (saving U.S. $69 million)

-- a reduction in U.S. annual contributions to the Fund for Special Operations (FSO) from $200 million to $175 million

-- a substantial increase in the convertable currency contributions of the larger Latin American countries to the FSO

-- a tripling of the shares of the nonregional members over their initial shares of capital

It is probable that some, maybe all, of these hard fought achievements would be lost in any renegotiation, particularly if the U.S. were to reduce substantially its total contribution. Any renegotiation would take from six months to a year, or longer, given the necessity for parlimentary approval in some member governments. In the meantime, the lending program would come to a halt.

A cessation of lending by the IDB and ADF would have serious adverse repercussions on our national security and foreign policy. Countries and regions of growing importance to U.S. national security, such as Pakistan, Central America, and the Caribbean, would be especially hard hit as a result. Obviously such action would also raise fundamental questions about the reliability of the United States in fulfilling its international commitments and this country's intentions as regards its leadership role in Latin America and Asia.

Authorization of the full amounts in the bill is entirely consistent with current efforts to achieve savings in budgetary outlays during FY1980 and FY1981. Of the $4.0 billion to be authorized, $2.5 billion -- more than 60 percent of the total request -- is for callable capital subscriptions to the IDB, which are virtually certain never to result in budgetary outlays.

For the $1.5 billion in the request which eventually will result in budgetary outlays, appropriations are being sought over the period FY1980 - FY1983. However, the budgetary impact of the drawdown of these funds will be minimal because that drawdown is tied to disbursements required to implement bank projects which take a minimum of five years to complete. We estimate that this bill will result in zero budgetary outlays in FY1980. Budgetary outlays for the total request of $4.0 billion will be less than $7.0 million in FY 1981 and less than $33 million in FY 1982. Furthermore, as directed in the authorization and in the Conference Report, procedures for drawdowns will be changed to delay outlays as long as possible.

It is important that the House act promptly to restore full funding to last year's authorization request. Such action is essential to U.S. national interests.

The 1980 Legislation

This year's bill focuses on the poorest countries of the world. IDA recipients include virtually all countries with annual per capita incomes below $320, in addition to scattered countries with slightly higher income levels. Their total population is more than one and one-quarter billion. The AFDB lends to African countries with incomes averaging $460 per year, and with a total population of 200 million.

There should be no doubt about the overwhelming need among the prospective IDA and AFDB recipients for these programs to be undertaken during the 1980s. Not only do these countries have the lowest per-capita incomes in the world, they have also experienced the slowest economic growth in the post-OPEC era, barely outpacing population growth. On average, over one half of their populations is mired in absolute poverty where hunger, malnutrition, illiteracy, disease, high infant-mortality, and low life-expectancy are an inevitable way of life.

The sum effect of these proposals will be to provide additional lending of over $15 billion during the first half of the decade to the world's very poorest. This means new programs to increase food production and alleviate hunger, to improve health, sanitation, housing, nutrition, and education, to build critical development infrastructure, and to limit burgeoning

Channelling assistance through the multilateral development banks (MDBs) has the advantage of complying fully with our domestic requirements for budget stringency. U.S. participation in the MDBs is the most cost-effective approach available to providing substantial amounts of development assistance to the Third World. Enormous fiscal advantages derive from our MDB participation because the burden for providing development assistance is shared with other countries, because the MDBs leverage our paid-in contributions through borrowings in world private capital markets, and because the MDBS, through increased purchases of U.S. goods and services, return substantial economic benefits to the U.S. economy -- including additional tax receipts which nearly offset U.S. budgetary outlays.

Furthermore, international burden-sharing through the banks is becoming more equitably and widely spread. The U.S. share in nearly every MDB in which the United States is currently participating has declined in recent years, while the lending levels of these institutions have increased. Other donor countries now contribute 75 percent of total MDB resources. Moreover, increasing amounts of our contributions are provided via callable capital, not a penny of which has ever left or is likely to ever leave the U.S. Treasury.

Burden-sharing, use of callable capital and the return of economic benefits to the U.S. economy provide a cost-effective combination to reconcile the need for a substantial, viable foreign assistance program with our current requirement for fiscal austerity. Through that combination, for example, the World Bank can now lend approximately fifty dollars for each dollar paid-in by the United States at no net cost to the U.S. taxpayer. Although the concessional MDB institutions such as IDA, where there is no callable capital, do not provide this leverage, major cost-effective advantages -- through burden-sharing and greater tax receipts via expanding U.S. exports -- accrue to the United States.

The authorization request for the United States' share of the Sixth Replenishment of IDA (IDA VI) totals $3.24 billion. The Sixth Replenishment will provide IDA with $12 billion in new resources for lending on concessional terms, over the period FY1981-FY1983, to the world's poorest countries. IDA VI cannot become effective without the participation of the United States.

This bill also would authorize United States membership in the African Development Bank, which for the first time will open its doors to nonregional members, thereby broadening the Bank's financial base, enhancing its access to private capital markets, and thus contributing more effectively to Africa's development. In conjunction with nonregional membership, the capital of the AFDB will be increased from $1.5 billion to $6.3 billion to support a lending program for a minimum of five years.

The proposed U.S. subscription to the AFDB would total $359.7 million, or 5.7 percent of the Bank's total capital. This share is sufficient to allow the United States to elect an Executive Director to the Bank Board. Twenty-five percent of the U.S. subscription, or $89.9 million, would be paid-in. The remainder would take the form of callable capital.

The Multilateral Development Banks in the 1980s

It is the view of the Administration that active, undiminished U.S. support for the multilateral development banks throughout the 1980s will be critical to fundamental U.S. economic, political, and security interests. Those interests include:

-- national security.

The banks comprise an important part of the international institutional framework which the United States must rely upon to enhance world security. The United States was the principal architect of that framework and recent events in Southwest Asia have demonstrated its importance to a secure, stable world environment. U.S. security interests are so far-reaching that defense of those interests would be unthinkable without relying upon the multilateral process through the existing institutional framework. The responses of the United States to the crises in Iran and Afghanistan and the results of those collective, collaborative efforts with much of the developing world, have demonstrated the importance of the multilateral process in promoting our foreign policy and national security interests. The United States must therefore give its fullest support to the process in order to keep it working to support U.S. interests.

In support of collective security action, the banks are critical to the maintenance of political stability in each of the major regions of the world and in key countries. One need only scan the list of the largest MDB borrowers -- Mexico, Brazil, India, Korea, Pakistan, Egypt, Indonesia, Colombia, Yugoslavia, Kenya and Turkey -- to grasp the importance of the MDBs to U.S. security by way of their contributions to growth and material well-being, and thus to political stability in key regions of the world.

Finally, there is the growing importance of U.S. dependence on critical raw materials from the developing world. The United States is nearly totally dependent upon the developing countries for supplies of bauxite, tin, manganese, and natural rubber, as well as certain food-stuffs. The United States and the rest of the Western World have a vital stake in promoting the stability and growth of the economies of developing countries which produce critical new materials and in retaining access to these supplies.

-- <u>the health of the international economic system</u>.

In 1979, MDB loan commitments totalled nearly $14 billion. This represents by far the largest official source of external capital for the developing world. As such, the MDBs contribute in a major way to economic growth and stability in recipient developing countries and in rapidly expanding trade between the Third World and the developed countries. In providing dispassionate policy advice, in preparing development projects based upon objective economic criteria, and in insisting upon rational economic policies within recipient countries, the MDBs are an important, respected force for the maintenance of an efficient, responsive international market economy. The impact of the banks in this regard, and their resulting contribution to the health and resilience of the world economy, is often overlooked but cannot be overstated.

Another intangible is the inducement of the banks to cooperative efforts among developed and developing countries, where relations in the recent past had too often been characterized by confrontation and hostility, to resolve pressing international economic problems. Cooperation here means developed and developing countries working together to focus bank policies and resources to respond to critical world needs. Most recently, this has meant both shifting MDB lending away from traditional infrastructure to agriculture and rural development to more directly benefit the poor and to increase food production, and greatly expandin lending to increase developing country energy production.

The banks also contribute to the effort to recycle funds from the oil producing countries to the developing world. Recent oil price increases will add about $14 billion to the current account deficits, totaling approximately $50 billion, for the oil-importing developing countries this year. Though the basic objective of bank loans is to promote long-run development in recipient countries, their role in this regard will become more prominent and vital to the world economy in the 1980s.

-- <u>direct U.S. economic benefits</u>

The most rapidly growing developing countries which, not coincidentally, are among the largest MDB borrowers, are also the most rapidly growing export markets for the United States. Generally, non-oil developing countries account for about 25 percent of U.S. exports, including one-quarter of U.S. manufactured exports.

These markets have become more important to U.S. trade than the entire European Community.

Through the contributions of other MDB donors, which on average comprise 75 percent of the total, and through the use of callable capital, MDB loans result in expenditures on U.S. goods and services well in excess of U.S. contributions to the banks. From the inception of the banks through 1978, the cumulative current account surplus for the United States directly attributable to MDB activities (the purchase of U.S. goods and services, net interest payments to U.S. MDB bondholders, and MDB administrative expenses in the United States), has been $11 billion. Cumulative U.S. paid-in contributions to the banks, by comparison, totaled $7 billion. This means that every dollar contributed to the MDBs results in $1.57 being injected directly into the U.S. economy.

The total economic effects, however, are much larger and more broadly based than the effects directly observable from our balance of payments. That $1.57 becomes the income of a U.S. exporter, bondholder or Bank employee residing in the United States. It is in turn respent, resulting in multiple increases in U.S. national income, employment, and Federal Government and local tax receipts.

Treasury analysis shows that over the period 1977-1978 every dollar contributed to the MDBs has resulted in an increase of U.S. GNP of $3.00. This three for one multiplier effect is sizable and stems, in part, from the unique characteristics of the MDBs, i.e., their multilateral character which provides for other donor country contributions and the availability of callable capital which permits substantial borrowing on private capital markets. Total U.S. GNP growth directly attributable to MDB activities averaged $2.7 billion over 1977-1978, raising net Federal tax receipts by $720 million annually and reducing the net cost to the Federal budget for our participation in the banks to $170 million each year. If increased local tax receipts were included the net cost to the American taxpayer probably would be minimal.

Developing Country Prospects for the 1980s

The record for the developing countries over the past two decades, which spans the work of the MDBs including IDA, shows clear progress. During the decade of the 1960s and up to the 1974 surge in OPEC oil prices, gross domestic product for the developing countries grew at six percent or more annually, exceeding growth in the industrialized countries. Developing countries' exports of manufactured goods grew at nearly 13 percent annually and their share of total world manufactured exports grew from six percent to ten percent during that period.

Moreover, each of the quality-of-life standards -- life expectancy, infant mortality, literacy, access to potable water and calories as a percent of daily requirements -- showed significant improvements during the 1960s and 1970s and a narrowing of the gap with the industrialized countries. Average per-capita income for the developing countries also has approximately doubled in real terms since 1960.

Despite recent progress in many areas, the prospects for the developing countries in the 1980s are not optimistic. In part this is because the world economy has moved haltingly, at best, to recover from the oil price increases and subsequent recession of the mid-1970s, and because the recovery remains far from complete. Thus, for the 1970s, while the per capita GDP of the major oil exporting countries grew at 6.6% per annum, per capita income grew at 3.6% for the middle income developing countries and fell off to only 1.7% per year for the poorest developing countries. For the poorest countries in Africa per capita growth was an imperceptible 0.2%.

In large part these meager results reflect a general slow-down in growth throughout the developing world in the 1974-1979 period. The causes of that slow-down -- surging oil prices, worldwide inflation slower growth in the industrialized countries, and declining real supplies of external capital -- cast long shadows over prospects for the 1980s.

Under the most optimistic assumptions of vigorous economic growth in developing countries in the 1980s, the World Bank has projected that their per capita income will increase 4.2 percent per annum. However, per capita income would increase by only 3.5 percent in the poorest developing countries and under 2 percent in Sub-Saharan Africa. Under more realistic assumptions, the per capita income of the developing countries can be expected to increase at an average rate of between 2.4 percent and 3.3 percent, but at only one percent or less in the poorest countries of Africa and under three percent in the low-income Asian countries.

Hence, per capita income in the poorest developing countries, with a billion and a quarter people, will probably increase only

$1-$10 per year over the next decade. The World Bank also estimates that, realistically, we can only expect to reduce the numbers of people living in absolute poverty -- that bare survival state conditioned by malnutrition, illiteracy, disease, high infant-mortality and low life-expectancy -- from 800 million to 600 million by the end of the century.

Equally disturbing is the fact that, while developing country food production is barely keeping abreast of overall population growth, in the poorest developing countries population growth at 2.4 percent a year has been outpacing food production which has grown at less than one percent annually since 1961. The combined effects of poverty and food insecurity, neither of which is being ameliorated in the poorest countries, are interacting to cause a worsening problem of hunger. Millions of people --more than three-quarters of whom live on the Indian subcontinent, in Southeast Asia and in Sub-Saharan Africa -- are afflicted by hunger. Short of a massive effort at increasing food production in the poorest developing countries themselves, this condition will remain widespread throughout the 1980s.

The Role of the Multilateral Development Banks and U.S. Objectives in the 1980s

These somber prospects have led us to conclude that the multilateral development banks must play a major world-wide development role in the 1980's. The MDBs have the technical expertise and the experience to use the capital resources which we propose to provide them for the coming years. Moreover, they do so in an extremely cost-effective manner through the sharing of the burden of foreign assistance with other donor countries and long term borrowing on capital markets with the backing of callable capital, at minimum cost to the U.S. taxpayer.

The MDBs are the most efficient, effective instruments to pursue broad-based development strategies in the developing world. At the micro-economic level, they follow detailed and rigorous loan appraisal processes to ensure that every dollar of development lending yields maximum benefits. Loan analysis is performed solely on the basis of relevant economic and technical considerations. Their apolitical nature also carries with it a special trust which enables the staffs of MDBs to influence strongly borrowing countries in the adoption of sound policies.

The United States also has significant policy leverage in the banks relative to both the proportion and dollar amounts of its contributions. Over the recent past, the United States has pursued a number of policy objectives in the MDBs to promote further their objective of helping the developing countries attain higher standards of material well-being and to help alleviate the conditions of absolute poverty. Among these objectives have been to reach the poor more effectively and efficiently, to increase food production substantially, and to increase both the the amounts and proportion of lending for projects designed to increase world energy supplies.

In response to U.S. urging, all of the MDBs have redirected the sectoral composition of their lending better to meet basic human needs and to ensure that proportionally more project benefits flow to lower income groups in borrowing countries. This redirection is reflected in the rapid growth of lending for agricultural projects.

World Bank Group lending for agriculture, one third of which is coming from IDA, has increased 145 percent in the past five years. For IDA alone, loans for the agricultural sector have grown by 427 percent. During that period, IBRD/IDA activities have provided the base for producing one third of all increased fertilizer production in the developing countries for the first half of the 1980s, one fifth of the total investment in rural road networks in developing countries, and one quarter of total public investment in developing country irrigation systems. Furthermore, 358 IBRD/IDA agricultural projects over these past five years have had the rural poor as their principal beneficiaries, and an estimated 60 million of the 100 million direct beneficiaries of these projects had incomes below the absolute poverty levels in their respective countries.

Currently, approximately 46 percent and 30 percent of IDA and IBRD lending, respectively, flows to the agricultural sector, up from 37 percent and 11 percent respectively in the early 1970s. Over 75 percent of combined IBRD/IDA agricultural assistance is now directed towards expanding food production. As noted in the forthcoming report of the President's Commission on World Hunger, the World Bank Group is the world's largest single source of external funding for developing world agriculture. The World Bank expects to finance projects which will contribute up to 20 percent of the increase in annual food production in its developing member countries in the 1980s. It is due to this effort that the President's Commission on World Hunger has concluded that the United States should strongly support the activities of the MDBs including an increase in U.S. contributions to the concessional windows of the banks.

An important means to implement the objective of more effectively and directly reaching the poor has been to encourage greater utilization of capital saving technologies. Such technologies have the advantage of increasing the productivity and incomes of poor people at low per capita costs by insuring that the maximum numbers of people benefit from MDB projects and by promoting the most efficient use of factor availabilities. The United States has sought greater utilization and development of capital saving technologies in the MDBs by encouraging policy decisions in the banks, urging increased MDB staff focus on the appropriateness of technologies, and constantly reviewing project loans to assure improved application.

The United States has also been at the forefront in urging the MDBs to adopt a comprehensive energy program. In the World Bank Group in January 1979, the Board of Executive Directors approved an expansion of the IBRD/IDA energy program. That program is now planned to grow to at least 15 percent of total Bank lending within five years.

Over the 1980-84 period, the World Bank Group will lend $7.7 billion for the exploration, production, and development of oil, gas, and coal, and for the construction of new hydroelectric facilities. The loans will be combined with approximately three times as much private and government financing. When the projects are in operation, they will produce additional primary energy fuel in oil importing developing countries estimated to equal between 2 and 2.5 million barrels a day of oil. This should help to increase world supply and thereby reduce pressures on world oil prices, as well as deal directly with one of the most critical bottlenecks to development.

The International Development Association

The International Development Association (IDA) is central to the attack on poverty in the poorest countries in the world. The record of that institution demonstrates clearly that developed and developing countries can work successfully to resolve common problems. Rhetoric and confrontation have no part to play in IDA programs. IDA recipients have come to appreciate and depend upon concrete development projects and programs which are designed to resolve real economic problems and to produce material improvement in the lives of their people.

It is important that the United States strongly support cooperative programs for mutual gain such as IDA. It serves to undermine those in the developing world who favor confrontation with the United States, to preempt proposals in North/South fora which are adverse to U.S. economic and political interests, and to enhance prospects for developing country support on issues of primary importance to the United States. At a time when global economic difficulties are exposing nearly all of the poorer developing countries to serious threats of political, economic, and social instability, IDA is making an invaluable contribution to our national security and other U.S. foreign policy objectives, via the multilateral process.

The rather bleak prospects for the low-income countries of Africa and Asia give IDA a vital development role to play in the 1980s. IDA is the largest source of concessional resources in the world, the largest source of external financing for the countries of Africa, and the centerpiece of multilateral efforts to utilize concessional resources effectively within broad-based development strategies. As such, it will be the major hope for the poorest developing countries and their one and one-quarter billion people over the next decade.

IDA will be crucial in determining whether per capita food production in the poorest LDCs will increase and whether real progress is made in alleviating world hunger. Nearly two-thirds of the external financing requirements of the low income developing countries will need to be met through disbursements of concessional capital, of which IDA will be the largest single source, during the last half of the 1980's. IDA will be key in determining whether the more than 800 million persons mired in absolute poverty can be significantly reduced by the end of this century. It will depend largely upon IDA as to whether the poorest developing countries will be able to undertake programs to improve education, health, sanitation, housing, nutrition, and population control throughout the 1980's.

About 90 percent of IDA lending goes to countries with annual per capita incomes below $320 (1978 dollars). None of IDA's recipients has a per capita income above $625. The 54 current IDA borrowers account for approximately 31 percent of the world's population, but only three percent of global gross national product. Average life expectancy in these countries is about 50 years, the adult literacy rate is 36 percent, and the labor force is expanding at two percent per year. Most of these countries are in South Asia and in Sub-Sahara Africa, two regions which borrowed 80 percent of IDA resources in FY1979. IDA's lending policy also focuses on development projects which reach the lowest 40 percent of the income earners within the recipient borrowing countries.

All IDA credits to date have been for a term of 50 years. After a 10-year period of grace, one percent of the credit is repaid annually for ten years, while in the remaining 30 years, three percent is repaid annually. There is an annual service charge of 0.75 percent on the disbursed portion of each credit to cover administrative costs. All credits are repayable in convertible currency.

During 19 years of operations through June 30, 1979, IDA has made development credits aggregating $16.7 billion to 74 countries. There has never been a default on an IDA loan by any borrower.

IDA VI Replenishment

A major step in assuring that IDA will be adequately financed to carry out its current task in the 1980s is the agreement which has been reached on a $12 billion replenishment of IDA for lending over the years FY1981 through FY1983. The proposed Sixth Replenishment will enable IDA to expand its lending from an average of $3 billion per year during IDA V, to $3.5 billion in FY1981, $4.0 billion in FY 1982, and $4.5 billion in FY1983. The $12 billion IDA VI replenishment represents a real increase of only 4.5 percent over IDA V, the minimum considered necessary to spur additional growth in the poorest developing countries. The increase in IDA VI is far below those of previous IDA replenishments.

It must be noted that IDA VI cannot become effective without full U.S. participation. Unless additional funds become available, the Association will exhaust its commitment authority by June 30, 1980, with drastic consequences for the poorest, most populous countries of the world.

The IDA VI negotiations were protracted and difficult. On the one hand, it was widely recognized that the needs of the poorest developing countries are immense and growing and that growth among a number of the countries had been stagnating in recent years. As a result, the World Bank originally proposed a replenishment of $15 billion. On the other hand, a number of donors, including the United States, faced severe budgetary constraints. These opposing views eventually reached a compromise agreement for a $12 billion replenishment despite the views of a number of donors that the urgency of the poverty problem among the poorest developing countries demanded a larger replenishment package. Nevertheless, the agreement reached will permit a 4-5 percent annual real growth in IDA lending over the period, FY1981-FY1983.

The U.S. share of IDA VI will be 27 percent, sharply lower than the 31.04 percent U.S. share of IDA V. The U.S. decline will enable the level of the U.S. contribution to show no real growth relative to IDA V -- total lending will rise 4-5 percent while the U.S. share declines by 4 percent. The U.S. share will total $3.24 billion, or an annual U.S. contribution of $1,080 million. The full U.S. contribution must be authorized. Otherwise the United States could not participate in the replenishment and IDA VI, which took more than a year to achieve, would have to be renegotiated. In the interim IDA lending would cease.

It was through improved burdensharing in IDA IV that a modest real increase in IDA's development resources will be achieved. The large reduction in the U.S. share was offset by substantial increases in the shares of Germany (from 10.9 percent to 12.5 percent) and especially Japan (from 10.3 percent to 14.7 percent). For the first time in an IDA replenishment the combined shares of these two countries will exceed that of the United States. Six members mostly developing countries, including Mexico, Argentina and Brazil, will provide IDA with resources for the first time. These burdensharing achievements were explicit negotiating objectives of the United States under the mandate of the Congress to reduce significantly the U.S. share in IDA.

Other negotiating accomplishments included agreement that:

-- Energy lending would expand rapidly during IDA VI, thus increasing world supplies and helping to ease upward price pressure.

-- IDA's major thrust would continue to be in reaching the poor. The proportion of IDA lending to agriculture and rural development would expand through FY1983. Lending for the urban poor would also increase.

-- Supervision and evaluation of IDA projects would be stepped-up using standards and procedures set out in detail during the negotiations, thereby enhancing the operating efficiency of what is universally recognized as a superbly run institution.

Replenishment of IDA, as agreed in these negotiations, is essential if the poorest developing countries are to have any prospect of achieving meaningful growth in the 1980s. IDA VI is also necessary if we are to move toward alleviating world hunger, and reducing absolute poverty during the decade. It will make an important contribution toward meeting worldwide energy needs in the coming years. Finally, the continued strong presence of IDA throughout the poorest regions of the Third World will be critical to the maintenance of political and economic stability, and ultimately peace. We could pay a heavy price by its absence.

U.S. national interest dictates that we fully support this replenishment of IDA.

United States Membership in the African Development Bank

Development performance in Africa throughout the 1970s has been particularly disappointing. For the poorest countries - the bulk of the countries in Sub-Saharan Africa - per capita income growth for the decade averaged 0.2% per year. This means that throughout the 1970s much of the population of Sub-Saharan Africa increased their incomes by less than one dollar per year. The "middle income" countries of Sub-Saharan Africa with an average annual per capita income of $460 fared little better. Per capita income for these countries increased at 1.4 percent per year, the lowest growth rate of any region of the world, including the poorest, ~~most~~ populous countries of Asia.

Furthermore, prospects are that per capita income growth will continue to either stagnate or improve imperceptibly throughout the decade of the 1980s. The World Bank projects an annual increase of between 0.7 and 1.9 percent for the poorest African countries and between 0.7 and 2.2 percent for the "middle income" countries, depending upon low or high growth assumptions.

Even such per capita income growth notions fail to reflect the immense development problems facing the developing countries of Africa in the 1980s. These countries have the lowest literacy rates, the lowest life expectancies, the highest population growth rates, and the largest percentage of people living in absolute poverty of any major developing region on the globe. This is somewhat ironic given that Africa is perhaps the richest of the developing country continents in natural resources - with large sources of bauxite, oil, potential hydroelectric power, manganese, copper, precious minerals, and vast potential for agricultural production.

It is concern over the development prospects for the countries of Africa, our common cultural heritage with the Sub-Saharan countries and the long-standing policy of this Administration to expand and strengthen U.S. ties with Africa that has resulted in our proposing U.S. membership in the African Development Bank (AFDB).

The AFDB was established in 1964, to lend at near-market terms for the economic and social development of its African members and to promote regional cooperation. To meet the challenge of Africa's poverty, loans are provided primarily to strengthen the agricultural sector and to finance critically needed infrastructure. The AFDB's lending activities are financed through member country paid-in capital subscriptions and borrowings in international capital markets.

While the United States and other nonregional countries are members of the AFDB's concessional loan affiliate, the African Development Fund, membership in the Bank to date has been restricted to African nations. The limited capital resources of its African members have severely restricted the AFDB's lending program and its access to private capital markets.

Consequently, in May 1979, the Governors of the AFDB invited nonregional countries to join their institution. Nonregional membership will expand and diversify the Bank's financial base and greatly enhance its access to private capital markets. As a result, the Bank will be able to increase its lending program substantially over the next five years and contribute more effectively to development, of the continent.

Results of the AFDB Negotiations

Active United States participation in the nonregional membership negotiations and support for U.S. membership in the AFDB were based on numerous U.S. interests which Bank membership would serve. The U.S. has rapidly expanding economic and political interests in Africa which would be furthered by supporting the continent's development through the AFDB.

In addition, United States membership in the African Development Bank was seen as another means to concentrate increasing development assistance on the poor. Most of the countries which are "middle income" for Africa -- and thus receive nonconcessional AFDB loans -- are at a level of development far below that of the "middle income" countries of other regions. The middle income countries of Sub-Saharan Africa have an average per capita income of $460 compared to $990 in other developing regions.

The multilateral character of the AFDB would provide a firm basis for sharing the cost of Africa's development with other countries. In the 1960s, the United States had already entered into similar multilateral partnerships with the nations of Latin America and Asia through the Inter-American Development Bank and the Asian Development Bank. Participation in the AFDB would complete this series of partnerships in an established and recognized pan-African institution.

In addition, by financing the basic infrastructure needs of African countries (roads, power, water supply, and sewerage) and agricultural projects, the Bank would complement increasing U.S. bilateral assistance efforts in Africa which focus more on meeting basic human needs. The AFDB would also complement IDA's activities by directing two-thirds of its lending to African countries with annual per capita incomes between $320 and $700, while IDA concentrates its resources on those African nations with less than $320 per capita.

In conjunction with the entry of nonregional members the capital of the Bank will be increased from about $1.5 billion to $6.3 billion, over a five year period. Of this increase, the regional members would provide 57 percent or $2.8 billion. The 21 nonregional countries seeking membership -- the countries of Western Europe, Canada, Japan, Korea, Yugoslavia and Kuwait as well as the United States -- would subscribe $2.1 billion. Twenty-five percent of the increase, or $1.2 billion, will be paid-in capital with the remaining seventy-five percent ($3.6 billion), in callable capital.

The proposed U.S. subscription would total $360 million -- 5.7 percent of the Bank's total capital and 17 percent of the nonregional share. The U.S. nonregional share is equivalent to the U.S. share of the current replenishment of the African Development Fund. This share represents an effort to balance our interest in increased burden-sharing with other donor countries with our desire to become more actively involved in the economic and social development of Africa.

In order to accommodate adequate representation on the Board of Directors by the nonregional countries, the Board will be expanded from the current nine to eighteen members. Twelve Directors will be elected by the regional members and six by the nonregional members, reflecting the proportional participation of each group in the capital stock of the AFDB. The size of the proposed U.S. share of AFDB capital will enable the United States -- alone among non-regional countries -- to elect its own Director to the Bank's Board.

U.S. membership in the AFDB comes at an opportune time. It is fitting that the United States should join a major pan-African institution, as the largest nonregional member, during a period when our overall relations with the nations of Africa have experienced dramatic improvement. The Sub-Saharan region remains politically volatile and the rapid expansion of the AFDB will help to stabilize the region by strengthening the healthier independent African nations, promoting pan-African cooperation, and assisting the region to evolve peacefully toward full political autonomy.

Finally, recent poor growth performance of the middle-income African countries and cloudy prospects for the 1980's show the necessity for a sizeable expansion of the African Bank's lending program. These countries have a critical need to diversify their economies: low growth projections for the 1980's are due, in large part, to the high share of slow growing primary products in their exports which will limit overall export expansion. Furthermore, many of these countries, including Kenya, Ivory Coast, Morocco, Nigeria and Gabon, among others, have demonstrated rapid development potential and the capability of absorbing capital resources efficiently.

Treatment of U.S. Subscriptions to IBRD and ADB Callable Capital

The Administration is also proposing amendments to those legislative provisions enacted by the Congress in 1977 which require that full appropriations be obtained prior to U.S. subscriptions to the Selective Capital Increase of the IBRD and the Second Capital Increase of the ADB. Under the proposed amendments, subscriptions to IBRD and ADB callable capital stock could be made after program limitations on the subscriptions are enacted in the Foreign Assistance Appropriations Act, rather than actual appropriations.

The proposed amendments would make consistent the statutory terms under which the United States can subscribe to IBRD and ADB callable capital stock with the terms provided in the authorizing legislation for the proposed replenishment of the IDB, as well as with the provisions in this bill for initial subscriptions to the capital stock of the AFDB. The amendments are essential to allow implementation of the President's FY 1981 Budget which proposes enactment of program limitations in the FY 1981 Foreign Assistance Appropriations Act for U.S. subscriptions to callable capital stock in the MDBs, including the IBRD and ADB.

The change in the treatment of callable capital is being proposed because the appropriation for the full amount of callable capital and the resulting scoring of the appropriated amounts as budget authority distort the true size of the request for the MDBs.

The budgetary and appropriations treatment of callable capital is an issue that has been under intense consideration for over a year both within the Administration and between the Administration and Congress. Changing the treatment of callable capital was discussed last year during consideration of H.R. 3829. At that time, the Committee approved language which authorized U.S. subscriptions to callable capital of the Inter-American Development Bank without requiring prior appropriations to fund these subscriptions.

The "callable capital" concept is one of the most attractive features of the multilateral development banks and results in considerable budgetary savings for the U.S. Government. With callable capital as backing, the MDBs are able to borrow most of the non-concessional funds they require in international capital markets. The cost to the U.S. Government of subscriptions to callable capital is solely contingent in nature, since callable capital can only be used to meet obligations of the MDBs for funds borrowed or guaranteed by them in the unlikely event that the banks' other resources are insufficient to meet those liabilities.

The risk of a "call" is extremely slight. The loan portfolios of the MDBs are distributed broadly, and major defaults are unlikely. Even if a number of their largest borrowers were to default, the MDBs have very considerable financial assets upon which they could draw. Moreover, prior subscriptions to individual MDBs totalling $11.5 billion have been funded by the Congress against potential U.S. liabilities, of which $8.4 billion relates to U.S. subscriptions to IBRD and ADB callable capital, the two institutions for which amendments are being proposed. In the IBRD, all prior U.S. subscriptions to callable capital have been fully funded. In the ADB, of the $736 million in U.S. subscriptions to callable capital, all but $126 million has been appropriated.

It is therefore virtually certain that there will never be budget outlays resulting from U.S. subscriptions affected by these amendments. Thus, as in other donor countries, we propose to cease treating callable capital subscriptions as though they would have an outlay impact, when that is not the case.

Conclusion

There is a very real need for continued growth in IDA lending, and for a strengthening and expansion of the African Development Bank's activities in the 1980s, as provided in this bill. Together, these proposals will act to improve materially the lives of one and a half billion of the world's poorest people, residing in the world's poorest countries.

The Sixth Replenishment of IDA is essential if the poorest countries, in the 1980s, are to increase per capita income levels meaningfully, reduce the numbers of people living in absolute poverty, make progress toward alleviating world hunger, continue to narrow the gap with the middle-income and developed countries in life expectancy, literacy and infant mortality, build the basic infrastructure required for development, and meet their energy needs.

U.S. membership in the AFDB and expansion of that institution's capital base are required to promote economic progress in Africa, expand U.S. economic and political interests there, and solidify recent improvements in U.S. relations with a large number of African nations.

Continued emphasis on the MDBs to channel an increasing proportion of U.S. development assistance is fully consistent with our domestic concerns over cost-effectiveness and fiscal austerity. The MDBs allow us to reconcile the overwhelming need for a viable development assistance program throughout the 1980s with the pursuit of a tough domestic anti-inflation program, because they provide enormous fiscal advantages. These include burdensharing of development assistance with other countries, the leveraging of U.S. contributions through borrowings in world capital markets and purchases of U.S. goods and services which return substantial economic benefits including increased tax receipts which nearly offset U.S. budgetary outlays for our participation in the banks.

I strongly urge your support for U.S. participation in the Sixth Replenishment of the International Development Association, for U.S. membership in the African Development Bank, and for changes in the budgetary and appropriations treatment of U.S. subscriptions to the World Bank and Asian Development Bank callable capital.

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STATEMENT OF THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
AND RELATED PROGRAMS
COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES

I. INTRODUCTION

I am pleased to be here today to endorse legislation providing for the maintenance of the U.S. share of International Monetary Fund quotas and the Administration's Fiscal Year 1981 appropriations request for the multilateral development banks (MDBs). We meet in the context of a difficult international situation which is characterized by greater tension -- in both the strategic and economic spheres -- than has been the case in recent history.

The tension affecting our strategic interests is most clearly linked to events in Southwest Asia. The unrest in Iran and the Soviet aggression in Afghanistan have heightened awareness throughout the world of the vulnerability of the world's major oil-producing region to both internal instability and external aggression. These developments clearly threaten our national interests, and we have set in motion a comprehensive program of action to reinforce the U.S. political and military position in the region and elsewhere.

The economic tension stems from the somber global economic outlook. Much of the 1970's was characterized by high inflation, soaring energy costs, low growth rates, and unprecedented imbalances in external payments. Largely as a result of various cooperative efforts, the international community weathered the economic turbulence reasonably well. Nevertheless, adverse oil market developments have again radically affected economic prospects. Many economic problems are not only likely to persist for the foreseeable future but may well intensify. The re-emergence of a large current account surplus in the OPEC countries -- projected at about $120 billion for 1980 -- and the inevitable generation of a corresponding deficit in non-OPEC countries will make serious balance of payments pressures inevitable for a growing number of countries.

Events in the Middle East have driven home dramatically the linkages between foreign policy and economics. Political and military concerns cannot be addressed in isolation from the realities of the world economy, and conversely all basic economic issues have a large political element. We can be successful in the pursuit of our broad global objectives only if we deal with both the strategic and economic crises which we face, and the inter-relationships between them.

The Administration response to the increased tensions in both the strategic and economic arenas has relied heavily on the international institutional framework which has evolved since World War II. This framework was designed under U.S. leadership to provide a system whereby all countries, large and small, could turn to seek cooperative solutions to their fundamental concerns. In the foreign policy area, the United States has recently turned to NATO, the United Nations, and the World Court. Economically, we rely heavily on the institutions which are the subject of today's hearings.

The International Monetary Fund (IMF) and the multilateral development banks (MDBs) are the front lines of defense for the world economy. During the 1970's, they were pivotal factors which both facilitated needed economic adjustments and helped sustain growth: the IMF through its surveillance and oversight activities and also through its expanded and liberalized financing facilities, and the MDBs through their increasingly important role in Third World development.

The distinct but complementary operations of these institutions serve U.S. interests greatly. They will be invaluable assets in facing the growing economic and financial problems of the new decade. The uncertain world economic environment -- which the Soviet Union will seek to exploit -- makes it all the more important for the United States to assure that the IMF and the MDBs can respond effectively to the needs of their members. In the economic arena, as in the international political and military spheres, the United States cannot maintain an effective leadership role -- and assure our national security -- unless we are willing to provide resources adequate to the dangers confronted.

The Administration's requests for both the International Monetary Fund and the multilateral development banks are designed to do that. I am submitting for the record a detailed background paper which deals fully with the Administration's request and provides specific material on the operations of the Fund and the banks.

In today's testimony I want to emphasize my conviction that it is absolutely crucial for the United States to continue its strong support for these institutions. They are valuable examples of successful international cooperation. More importantly they are directly supportive of vital long-term U.S. foreign policy interests. Now is not the time to undermine our influence in these institutions or reduce the constructive role they play in global economic developments. The stakes are too high.

II. THE INTERNATIONAL MONETARY FUND

The purpose of the IMF is the maintenance of a strong and orderly international monetary system. It is not foreign aid. It is not commodity financing. It is not like any other institution in which our country participates.

The IMF has two basic functions, and they are closely related. The first is general guidance over the operation and evolution of the international monetary system. The second is provision of temporary financing in support of adjustment programs by IMF members facing balance of payments problems.

In its first function, the Fund has been given important new powers of surveillance over exchange rates and the balance of payments adjustment process. The IMF membership has also established the objective of making the Special Drawing Right the principal reserve asset in the system, in order to avoid the instabilities inherent in a system based on a multiplicity of national currencies.

These changes have paralleled and to a large extent reflected changes in the position and role of the dollar in the system. The original Bretton Woods arrangements assumed a fixed and central role for the dollar with the U.S. position essentially passive and the product of other countries' actions in pursuing their own balance of payments policies and objectives. That arrangement ultimately became both unsustainable and intolerable in terms of U.S. economic interests. The new arrangements have provided much more scope for balance of payments adjustment by the United States and recognize the need for greater symmetry in encouraging adjustment by all nations -- those in surplus as well as those in deficit.

At the same time, the world's reserve system has been undergoing significant change. Increases in the relative economic size and financial capacity of other major countries have tended to bring some growing use of their currencies in international transactions and reserves. On the one hand, such a development could help to mitigate some of the burdens on the dollar and U.S. financial markets that arose from its extremely large international role. On the other hand, the process of change can itself be unsettling and disruptive, and there is a widespread view that increasing reliance on the SDR -- an internationally created and managed reserve instrument -- would be preferable to development of a full-scale multiple currency reserve system. The IMF over the past few years has taken a number of important steps to promote the role of the SDR and is presently considering a potentially significant further step in its examination of the substitution account.

The dollar nonetheless remains critically important to the operation of the international monetary system, and the

U.S. economy remains a powerful element of that system. This will continue to be the case, and we recognize and accept the responsibilities incumbent on the United States to maintain a sound economic position and a stable dollar. At the same time, a strong IMF -- able to encourage effective economic and balance of payments adjustment by all countries and able to guide the orderly evolution of the resersve system -- is of direct and immediate importance to our economy and to our efforts to maintain the integrity and strength of the dollar.

The IMF's second main function, balance of payments financing for its members, is closely linked to its broader role in guiding the overall balance of payments adjustment process. The aim is to encourage timely adjustment by individual countries through policies that disrupt national or international prosperity as little as possible.

This objective is in the interest of every country and every IMF member is obligated to support it in concrete, financial terms. This is a critically important point to bear in mind. The IMF is a revolving fund of currencies, provided by every member. Every member must allow its currency to be used by the IMF, and every member in turn has a right to draw on the IMF's currency pool when in balance of payments need. When a country's currency is used by the IMF, that country receives an automatically available claim on the IMF, which it can use to get needed foreign exchange if it runs into trouble.

Financing flows back and forth through the IMF depending on balance of payments developments. There is no set group of lenders or borrowers. Many IMF members, both developed and developing, have been on both sides of the financing and drawing ledger, providing their currency at times and drawing other currencies at other times. In fact, while the U.S. quota subscription has been drawn upon many times over the years, our own drawings of $7.3 billion on the IMF are the second largest of the entire membership. As a net result of all IMF transactions in dollars over the years -- dollar drawings and repayments by others, and U.S. drawings -- the IMF's holdings of dollars currently exceed the U.S. currency subscription to Fund resources. Consequently, there has been no net use of the U.S. currency subscription by the Fund over its 35 year history.

Quotas are absolutely central in the IMF. They are the IMF's permanent resources. They determine the amounts countries can draw. They determine the distribution of SDR allocations. They determine voting power. Because of these important advantages, the competition is always for increases in shares -- not for reduction, as is the case in many other institutions.

IMF quotas are reviewed periodically and have been increased four times in the IMF's history in response to growth in the world economy and international trade and finance. These increases have been needed to keep the Fund's financing capability in some reasonable relation to demands that may arise.

The proposal for this quota increase resulted from a review that began in 1977. Quotas had fallen to an unrealistically low level, about 4 percent of world trade compared to 12 percent earlier, during a period of massive expansion of payments imbalances and international financing needs. The recognition that an increase was necessary came early in the review -- even though a long period of negotiation was required to reach agreement on the precise amount and shares.

The 50 percent increase ultimately agreed in December 1978 -- raising total quotas from about SDR 39 billion to SDR 58 billion -- will barely halt the decline in the relative size of the IMF over the next five years. Many countries pressed hard for a larger increase. The quota increase proposed for the United States is 50 percent, amounting to SDR 4,202.5 million or about $5.3 billion at current exchange rates, and will raise our quota from SDR 8,405 million to SDR 12,607.5. This maintains the U.S. quota share intact at 21.5 percent. Given the continuing large role of the U.S. economy and the dollar in the international monetary system, maintenance of an appropriate U.S. share and influence over decisions on the international monetary system is particularly important. An increased U.S. quota will augment the foreign exchange resources available to us should we need them for balance of payments purposes. Without the proposed increase in the U.S. quota, our veto power over major IMF decisions affecting the operations of the entire system could be jeopardized.

Developments since completion of the quota review and the IMF Governors' resolution formally proposing the increase have only strengthened the need.

We are now faced with the consequence of another round of huge oil price increases and with events in Iran and Afghanistan that greatly heighten the level of world concern and tension. These developments make it absolutely essential that we have in place the institutional framework for assuring monetary stability and providing advice and support to countries as they contend with radically altered economic prospects.

Both financing and economic adjustment are going to be more difficult in this environment. The private financial markets will have to meet the bulk of expanded international financing needs -- no other source is available -- and development aid must continue to increase. But some countries will run into growing financing difficulties and pressures to bring their external balances into line with sustainable flows of financing.

Without adequate financing, the efforts of deficit countries to adjust would necessitate curtailing economic growth so abruptly that it would cause severe human hardships and could well jeopardize the political stability of a number of countries. Countries could also be forced to adopt restrictive trade policies in an attempt to ration the foreign exchange available to them, or to resort to aggressive exchange rate behavior. In today's interdependent world, the adoption of such policies -- particularly because it could lead to retaliatory policies or emulation by other countries -- could have disastrous worldwide repercussions and would be reminiscent of the self-defeating economic policies followed in the 1930's.

The task of assuring a strong and stable international monetary system in the circumstances of the 1980's will be formidable. We cannot predict the amount of IMF financing that will be needed. No one can. But we can foresee very tangible dangers to the system and to ourselves if the Fund's resources prove to be insufficient when they are called on. It is therefore critical that IMF operations in this period of stress be buttressed by prompt Congressional approval of the proposed quota increase. In so strengthening the base of the international monetary system, the United States will not only be contributing enormously to an international environment conducive to effective foreign policy but will also be strengthening a source of balance of payments financing on which it has drawn many times itself.

Before concluding this discussion of the IMF, I would like to note that the Supplementary Financing Facility, for which U.S. participation was approved by the Congress late in 1978, has proved to be an extremely important temporary reinforcement of IMF resources during a period of growing financial strain. The Facility began operation in early 1979 on the basis of financial commitments amounting to about SDR 7.8 billion. OPEC is providing over 40 percent the total with Saudi Arabia the largest single participant. To date, the facility has been used in conjunction with IMF programs totaling $3.0 billion and is assisting a wide variety of countries of special interest to the U.S. -- including Turkey, Jamaica, Peru, Korea, the Philippines and Sudan -- in dealing with severe payments difficulties. A number of countries are now discussing with the IMF programs under the Facility, and total use before the Facility expires (scheduled for early 1981 or 1982) should be substantial. This Facility, designed as a temporary bridge to the quota increase now in process, is a timely and valuable source of support for the Fund's operations in this period, and Congressional approval for it has proven to be extremely wise.

Finally, let me mention the question of the budget and appropriations treatment of this quota increase. The President's budget proposes that a program ceiling on the increase be provided in an appropriations act. We have been consulting closely on this question with interested committees, and it appears that considerable interest is developing in an alternative approach which would involve the following:

-- Appropriations would be required in the full amount of the increase, and that sum would be included in budget authority totals for fiscal year 1981.

-- Payment of the quota increase would result in budgetary outlays as cash transfers are actually made to the IMF on the U.S. quota obligation.

-- Simultaneously with any cash transfer, an offsetting budgetary receipt representing an increase in the U.S. reserve position in the IMF would be recorded.

-- As a consequence of these offsetting transactions, transfers to and from the IMF under the quota obligations would not result in net outlays or receipts.

-- Net outlays or receipts resulting from exchange rate fluctuations in the dollar value of the SDR-denominated U.S. reserve position in the Fund would be reflected in the Federal budget. These net changes cannot be projected and thus would be recorded only in actual budget results for the prior year.

We are continuing consultations on this matter. The point I would stress today is that under either the program ceiling contained in the President's budget or this alternative approach, U.S. payments on its quota subscription would not affect net budget outlays or, therefore, the Federal budget deficit.

Also under either approach, it is important that the appropriations action be denominated in SDR although I know this is a departure from normal practice. This is because our IMF quota -- and those of all other countries -- is denominated in SDR, the IMF's unit of account. We negotiated hard to maintain our quota share and influence over IMF decisions. There were many who sought increases in their own shares at our expense. We should not allow a cut through inadvertence, which could happen if the appropriation number were expressed in dollars and the dollar depreciated in terms of the SDR prior to implementation of the quota increase. An SDR denomination of the appropriation figure -- SDR 4,202.5 million -- will protect us against that danger

III. THE MULTILATERAL DEVELOPMENT BANKS

The United States has an important responsibility in working to establish and maintain an international economic environment which furthers the process of equitable economic growth in the developing countries. This reflects the realities of economic interdependence, in which the prosperity of each nation depends upon the well-being of others. The non-oil developing countries have, for example, become the largest single market for U.S. exports. In addition the countries of the developing world are an increasingly important factor in protecting U.S. security and other foreign policy interests. It is a simple truism to recognize that the prospects for developing country support on global issues of importance to the United States will be enhanced by U.S. cooperation on issues of keen interest to them. In the case of most of the third world countries, the fundamental concern is development.

Poverty exists on a large and pervasive scale in developing countries throughout the world. There are large gaps between developed and developing countries in terms of living conditions and the quality of life; in health and nutrition, literacy and education, life expectancy, and in the overall physical and social environment. The natural growth of population and the process of industrialization have compounded already immense problems of unemployment and underemployment and fueled a rapid increase in the size of urban populations most of which are without access to rudimentary health and sanitation services. In addition to new problems generated by this rapid urban growth, the primary concerns in low income countries -- with large numbers of rural poor and heavy reliance on agriculture -- remain with the requirements of the rural economy and the need to improve production of the small farmer.

The multilateral development banks (MDBs) are at the heart of international efforts to address these development concerns. They are unique institutions by which the United States can work cooperatively with developing countries in support of their aspirations for economic and social progress.

The banks have proven themselves to be effective instruments for promoting growth with equity. Last year they made loan commitments totaling nearly $14 billion which helped to finance 425 projects in 90 developing countries. During the past five years, IBRD/IDA activities have provided the base for producing one third of all increased fertilizer production in the developing countries for the first half of the 1980s, one fifth of the total investment in rural road networks in developing countries, and one quarter of total public investment in developing country irrigation systems. Furthermore, 358 IBRD/IDA agricultural projects over these past five years have had the rural poor as their principal beneficiaries, and an estimated 60 million of the 100 million direct beneficiaries of these projects had incomes below the absolute poverty levels in their respective countries.

The banks now account for between 10 and 15 percent of the total external resources moving to the developing world. This proportion is much higher for the poorer countries which do not have access to the international capital markets.

Important as this transfer of resource function is for the MDBs, a far more important contribution to development lies in the way their projects have become the principal catalyst for growth and contributed to rational sector and macro-economic policies in developing countries. In this regard, they have organized increasing amounts of co-financing from private as well as from other public sources.

The MDBs also have a key role in the transfer of technology and in providing sound advice on economic policy associated with their lending activity. This contribution to "institution building" and "human capital formation" permeates the process of project implementation and is perhaps the greatest contribution made by the banks to the long-term economic prospects of the developing countries.

It is the combination of project financer, financial catalyst, and institution builder which makes the MDBs such unique and important agents in the development process.

Throughout the history of bank operations, the United States has supported and encouraged those adaptations in bank operations which we believed would further increase the effectiveness of bank lending. Among the more important results of past U.S. initiatives are the shift in the sectoral composition of MDB lending to those sectors -- such as agriculture and rural development -- where project benefits accrue more directly to the poor, the use of the MDBs' considerable aid leverage to promote policy changes in the borrowing countries which favor the poor, and the recently emphasized stepped-up MDB lending to increase developing country energy supplies.

Reaching the Poor

To more effectively reach the poor, all the MDBs are engaged in modifying their organizational structures and their project identification and appraisal procedures.

The World Bank has established a Rural Operations Review and Support Unit (RORSU) and an Urban Operations Review and Support Unit (UORSU) to develop poverty impact methodology and to monitor and evaluate poverty-lending projects in their beginning, intermediate, and final stages. Ninety percent of the World Bank's rural development projects have had provisions for monitoring and evaluation units. These units assist in the identification of the project's beneficiaries, insure during the project implementation stage that the benefits are actually going where intended, and, finally, evaluate the impact of the project in terms of what changes were made in the lot of the poor.

The Inter-American Development Bank has designated a specific unit within the Bank's organizational structure to define low income groups and to monitor the bank's progress in reaching its current replenishment (1979-1982) goal to provide 50 percent of total lending to low income groups. In addition, the Asian Development Bank is undertaking a major expansion of its Post Evaluation Unit to facilitate its greater attention to data collection and benefit monitoring.

Capital Saving Technology

The United States has also been successful in seeking policy decisions through which the MDBs will place increased emphasis on the use of capital saving technologies in their projects. Since these technologies involve the productive and often innovative use of small-scale and labor-intensive processes, techniques, equipment, and tools which are less complex and costly than those usually employed by more developed countries, their application generally will: (1) create employment opportunities, increase productivity, and raise the incomes of poor people at lower per capita costs; (2) ensure that the greatest number of people benefit from development projects; and (3) promote the most efficient use of scarce resources within developing countries in accordance with relative factor endowments.

By strengthening their project appraisal activities at the preinvestment stage, the MDBs have enhanced their ability to select projects which incorporate techniques most appropriate to the circumstances and requirements of the borrowing countries. This has resulted in increased utilization of capital saving technology in individual bank projects. Most recently, capital saving technology -- in addition to continuing its important role in civil works construction projects -- has become an integral element in MDB-financed renewable energy and urban and rural development projects.

Economic Benefits of U.S. MDB Membership

As the Administration's chief fiscal officer, I am committed to budget restraint. At the same time, for the reasons I have outlined, the United States must maintain a reasonable program of foreign assistance. The multilateral development banks reconcile these needs.

First, other members contribute $3 for every $1 contributed by the United States. Second, supported by callable capital, the banks finance the bulk of their lending program through borrowings in the private capital markets. The result is that U.S. budget expenditures are multiplied many times over in actual MDB lending. For every dollar the United States has paid into the World Bank over the past 35 years, for example, the Bank has lent over $50 (at no net cost to the U.S. taxpayer, because increased federal tax receipts from IBRD activities, i.e. procurement, administrative expenses, and net interest, have been more than double U.S. paid-in contributions to the bank). Our development assistance gets maximum leverage when channeled through the MDBs.

In addition, U.S. producers and consulting firms have received the largest share of MDB-financed procurement contracts. This has led to a significantly beneficial impact on U.S. employment and GNP. For every dollar we have paid into the MDBs for the years 1977 and 1978, the U.S. economy has grown by an average of $3. Over the life of the institutions, they have contributed a net surplus of $11 billion to our current account.

The cooperation among countries within the MDBs contributes significantly to the substance as well as the atmosphere of U.S. ties with developing countries. U.S. participation in the banks also reflects a successful partnership with Europe, Japan, and Canada -- with whom we work closely on MDB financing arrangements. Any significant slackening of traditional U.S. support for the MDBs would both seriously jeopardize our relations with the developing world and weaken the confidence of our allies in U.S. ability to play a cooperative role across a broad range of international activities. Undermining such a pillar of the international institutional framework would also make it much more difficult for us to get the support of the developing countries for our positions in other international bodies on issues of central concern to our own national interests.

The FY 1981 Appropriations Request and Callable Capital

For FY 1981, the Administration has requested total budget authority of $1,666 million for U.S. subscriptions and contributions to the MDBs. In addition, because of the shortfall in actual appropriations for FY 1980 from what had to be assumed when the FY 1981 budget was prepared, we will be submitting budget amendments which will increase this amount modestly. The outlay effect of the request will be spread over time and, thus, will have only a minimal impact on this year's or next year's budget.

The amount of the FY 1981 request is much lower than that for last year. This is principally because we are seeking a program ceiling rather than budget authority for the callable portions of our capital subscriptions to the banks.

The "callable capital" concept is one of the most attractive features of the multilateral development banks and results in considerable budgetary savings for the U.S. Government. With callable capital as backing, the MDBs are able to borrow most of the non-concessional funds they require in international capital markets. The cost to the U.S. Government of subscriptions to callable capital is solely contingent in nature, since callable capital can only be used to meet obligations of the

MDBs for funds borrowed or guaranteed by them in the unlikely event that the banks' other resources are insufficient to meet those liabilities.

The risk of a "call" is virtually nil. The loan portfolios of the MDBs are distributed broadly, and major defaults are almost inconceivable. In the more than thirty year history of the World Bank, there has never been a loan default. Similarly there has never been a default at the Asian Development Bank (ADB). At the Inter-American Development Bank two very small loans were defaulted in the 1960's, but this was before institution of the policy that all loans have the recipient country's government guarantee for loan repayment. (One of the IDB loans was fully recovered and the loss on the other was $1.8 million.)

Even if a number of their largest borrowers were to default, the MDBs have considerable financial assets upon which they could draw. The first line of defense of the MDBs is their paid-in capital and accumulated reserves, which total over $6.0 billion at the World Bank, over $1.9 billion at the IDB, and $1.5 billion at the ADB. Moreover, prior U.S. subscriptions to MDB callable totaling $11.5 billion have already been funded by the Congress against the potential U.S. liabilities -- and other donor countries have committed themselves to much larger amounts. It is therefore virtually certain that there will not be budget outlays resulting from the callable subscriptions proposed in the legislation before the Committee.

Unlike other donor countries, however, the United States in its budgetary procedures has heretofore treated callable capital subscriptions as though they would have an outlay impact. The issue of changing the appropriations and budgetary treatment of callable capital has been under serious consideration for over a year both within the Administration and between the Administration and Congress. The Administration has concluded that appropriation for the full amount of callable capital, and the resulting scoring of the appropriated amounts as budget authority, distort the true size of the request for the MDBs and is not consistent with the treatment of other contingent obligations of the United States Government.

The Administration therefore proposes enactment of program limitations in the FY 1981 Foreign Assistance Appropriations Act for U.S. subscriptions to callable capital instead of actual appropriation and budgetary authority. We have also submitted proposed changes in the authorizing legislation which will enable us to make the subscriptions after program limitations are enacted. Full Congressional control over callable capital subscriptions is retained both by the program limitations and because subscriptions to callable capital and paid-in -- which must be appropriated in full -- must be made in specified proportions. The General Counsel of the Treasury Department issued opinions in 1975 and 1979 that appropriations are not legally required to back subscriptions to callable capital unless and until payment is required of the United States on a call made by an institution.

The Sixth Replenishment for the IDA (IDA VI)

The background paper submitted for the record details the specifics of the Administration's full appropriations request. I would like to highlight two of the larger components of the request: the sixth replenishment for the IDA and our remaining subscription to the Special Capital Increase of the World Bank itself.

The United States has important reasons for continuing to support IDA. We have a strong tradition of international leadership in mobilizing the international community to give special attention and effort to those most in need of help, and that is IDA's reason for existence. In this context, IDA has an excellent track record as an effective instrument for reaching the poor, providing job opportunities, and helping to meet basic human needs.

IDA is, in effect, the centerpiece of U.S. North/South strategy, and the symbol of our commitment to Third World Development. It serves to undermine those in the developing world who favor confrontation with the United States, to bolster U.S. economic and political interests in North/South fora, and to improve prospects for multilateral cooperation on issues of primary importance to the United

States. At a time when global economic difficulties have exposed a large number of the world's poorest countries to serious threats of political, economic, and social instability, IDA operations make an invaluable contribution to our national security and other U.S. foreign policy objectives.

The extremely somber economic prospects for the low-income countries underscores the importance of IDA's development role in the 1980's. IDA is the world's largest source of concessional resources. It is particularly important to Black Africa, providing valuable assistance to such key countries as Kenya, Somalia, and Sudan. Egypt and Pakistan are also important IDA borrowers. IDA will be crucial in determining whether per capita food production in the poorest countries will increase and whether real progress is made in alleviating world hunger. It will also depend largely on IDA resources -- utilized within broad-based development strategies -- whether these countries will be able to improve education, health, sanitation and housing standards and produce material improvements in the lives of the poor throughout the 1980's.

IDA expresses the determination of the more advanced countries to reduce, albeit slowly, the problems of absolute poverty in the poorer nations of the world. The 54 IDA borrowers account for approximately 31 percent of the world's population but only about 3 percent of the global gross national product. Approximately 90 percent of IDA's funds go to countries whose per capita income is below $300 per year (1977 dollars). Lending is concentrated on those sectors which promise to improve most directly the lives of the very poor.

With few exceptions, IDA recipient countries lack the physical and human resources to adapt quickly to the problems confronting the global economy. Their terms of trade have deteriorated. They have not been able to attract sufficient capital to maintain imports and thus sustain even their already low growth rates. Since 1974, the real value of their imports has declined. As a result, most of the poorest countries achieved per capita growth of only around 1 percent per annum during the 1970's.

Even with a major effort by the poorest countries themselves, additional concessional resources are required to achieve both higher rates of growth and greater progress in poverty alleviation. More than one-third of the total population of the developing world -- 800 million people -- still subsist in conditions of absolute poverty.

After eighteen months of negotiation, donor countries reached agreement last December on a $12 billion IDA VI to permit continued IDA lending for the three year period beyond June 1980. Relative to donors' gross domestic products, the size of the replenishment remains at roughly the ratio of IDA V and will thus permit a modest annual growth in IDA lending.

The United States joined other donors in supporting this replenishment -- noting, however, that our support was contingent on the enactment of necessary authorization and appropriations legislation. The United States insisted on a sharp reduction in the U.S. share. After lengthy negotiation, we achieved a reduction in our share from 31 percent in IDA V to 27 percent in IDA VI. This decline continues the downward trend in the U.S. share of IDA from its initial level of 42 percent and was accompanied by a substantial increase in the shares of Germany (from 10.9% to 12.5%) and Japan (from 10.3% to 14.65%). The reduction of four percentage points in the U.S. share constitutes a very significant improvement in the distribution of responsibility for providing funds for IDA, saving us $480 million over the life of the agreement.

A U.S. share of 27 percent of a $12 billion IDA VI replenishment results in an average annual U.S. contribution of $1,080 million. This represents virtually no increase in real terms in U.S. funding for IDA -- its annual lending rises by a modest amount, but our share declines by 4 percent. All real growth in IDA lending will be financed by other donors.

World Bank Selective Capital

In 1977, Congress authorized United States participation in a Selective Capital Increase (SCI) for the IBRD. The United States has been behind in its scheduled SCI payments since the first installment, however, even though 90 percent of our subscription represents callable capital and thus no budget outlays.

Reluctance to meet our full SCI subscriptions is ironic because the Bank's great success is to a large extent due to the leadership the United States has provided in it since its creation in 1946. The shortfall in U.S. funding is particularly inopportune now that the Bank, at U.S. initiative, has mounted a major program to increase world energy supplies. The World Bank's energy program will grow to at least 15 percent of total Bank lending within five years. It will amount to $7.7 billion over the period as part of projects totaling about $30 billion for the exploration, production, and development of oil, gas, and coal, and for the construction of new hydroelectric facilities. In operation, these Bank projects will produce additional primary energy estimated at 2-2.5 million barrels of oil a day, thus reducing by that amount potential world demand for OPEC oil.

A U.S. failure to complete our SCI subscription could lead other members to insist on a significant cutback in the Bank's annual lending program because doubts would be generated about

U.S. support for Bank lending throughout the 1980's. Such a cut-back in the lending program would be disastrous for our relations with the developing world, undermining Bank programs in countries and regions of particular concern to the United States (e.g. Egypt, Turkey, the Caribbean, and Central America) and heightening international monetary problems by increasing demand on private capital markets.

Subscription of the full SCI amount is also essential to maintain United States voting strength above 20 percent and thus protect the U.S. veto in the Bank. The veto ensures that no changes are made in the Charter which would have a detrimental impact on U.S. interests.

The African Development Bank

The U.S. subscription to the African Development Bank (AFDB) is an important new component of the FY 81 appropriations request. Subject to receiving authorization for U.S. membership in the bank, an initial appropriation of $18 million is being sought.

Membership in the AFDB to date has been restricted to African nations. The limited resources of the African members have, however, severely restricted the Bank's access to the private capital markets and its lending program. As a result, in May 1979, the Governors of the Bank agreed, subject to necessary ratification by member governments, to invite nonregional countries to join their institution. The proposed U.S. subscription would represent 5.68 percent of the AFDB's total capital and 17.04 percent of the non-regional subscription. The United States will therefore have its own Executive Director on the Board of the Bank.

The United States has direct economic, humanitarian, and political interests in assuring a strong and viable Africa where poverty is reduced, the pace of economic growth accelerated, and serious financial problems avoided. While a wide range of U.S. political and economic policies already contribute toward these objectives, our membership in the AFDB, the most prominent pan-African development institution, would help strengthen our ties with African nations and meet our growing interests in the region.

Other Regional MDBs

The remainder of the Administration's request is for appropriations for capital subscriptions and contributions for the Inter-American Bank (IDB), the Asian Development Bank (ADB) and Fund (ADF), and the African Development Fund (AFDF):

-- $51.6 million in paid-in capital for the IDB and $318 million for the Fund for Special Operations, the IDB's concessional lending window;

-- $25.2 million in paid-in capital for the ADB and $111.2 million for the ADF, the Bank's concessional window; and

-- $41.7 million for the AFDF, which provides concessional financing for Africa's poorest countries.

As noted above, most of these numbers will have to be supplemented by budget amendments to reflect the shortfall in actual FY 1980 appropriations.

These regional institutions were established to complement the activities of the World Bank Group and increase the direct involvement of the recipient countries in the development process. They now provide a central element in the development strategies of many friendly nations and are unique positioned to bring to bear a special regional expertise to local problems. The regional MDBs also facilitate the mobilization of additional resources from the developing countries themselves.

The Decision-Making Process

I recognize that one of the major concerns regarding the MDBs is whether the United States has adequate influence to promote its interests effectively through such multilateral institutions. The formulation of MDB policy and the extent of influence exercised by the United States in their decision-making involve both a formal and informal process.

The MDBs are like any other bank, or, indeed, any other corporate entity. They are controlled by a board -- in their case, of member country Governors and, through them, their appointed Executive Directors. Management is hired by the national representatives of the member countries to carry out the day-to-day functions of the banks within the policy framework set for the banks by the member governments. The management of the banks executes that policy under the general guidance of the Boards of Executive Directors. Their task is facilitated greatly by the fact that there exists among bank members a broad consensus on both the aims and the most effective usage of development lending.

In practice, influence also is manifest in a variety of informal ways -- official and unofficial meetings of national officials at the bilateral and multilateral level; informal discussions among the Governors at the annual meetings; informal meetings preceding and during the periodic replenishment negotiations; and countless exchanges between bank officials and national representatives at all stages of the formulation and implementation of the banks' lending programs. Subtly, and often imperceptibly, a country's interests are advanced in such ways, and these interests become woven into the fabric of MDB activities.

The cardinal test of U.S. influence is of course not procedure but substance -- whether the institutions have consistently pursued policies which promote the national interests of the United States. In my judgment, they clearly have done so and continue to do so. We have only to consider MDB lending programs in agriculture aimed at increasing production and providing employment, and now more effectively concentrated on reaching the poorest rural inhabitants. The expansion of developing country energy supplies is a second priority that the MDBs are employing which is also very much in our interests. The facts are that the United States has steadily reduced its share of contributions to the MDBs while preserving its influence. The MDBs are, moreover, a constructive arena for North/South cooperation on practical problems with the great confluence of interests among all MDB member countries making these institutions unique among North/South fora.

Restrictive Amendments

The majority of MDB recipient countries operate economic systems which are compatible with western oriented market systems. Moreover, most MDB lending is directed to countries which occupy strategic geographic positions, which are important sources of critical raw materials, or where the United States has other key political and economic interests.

There has understandably been serious concern however about loans by the MDBs to Vietnam and perhaps a few other countries. But this issue is largely moot, given the suspension of MDB lending to Vietnam and Afghanistan. I must urge you to oppose inserting restrictions on U.S. MDB contributions into law.

Under their charters, the banks cannot legally accept contributions which are subject to unilaterally imposed conditions from the United States or any other bank members.

Acceptance of such restricted contributions would be inconsistent with Charter provisions dealing with (1) the purposes of the banks, (2) the permitted uses of Bank resources, (3) the prohibition on political considerations affecting loan decisions, and (4) callable capital.

The fact that the MDBs could not accept U.S. contributions with country restrictions has been confirmed by legal opinions from the MDBs themselves, the Executive Branch, the General Accounting Office, the Congressional Reserach Service, the American Bar Association, and an expert group of the District of Columbia Bar. In 1975, the Inter-American Development refused to accept contributions earmarked for a specific purpose by the United States because such acceptance would have violated the charter of the Bank. The funds were accepted only after the earmarking requirement was repealed in subsequent legislation.

The imposition of restrictions by the United States would also be unwise from a policy standpoint. Other countries, which are increasingly important contributors, could well emulate the United States and impose restrictions which would not be acceptable to us. Clearly to start down this path would run the very serious risk of damaging the global development effort by crippling the ability of the MDBs to execute their operations objectively and efficiently.

The real issue posed by restrictive amendments, therefore, is continued U.S. participation in the MDBs. The adoption of such amendments would have the effect of taking the United States out of the banks. Such an outcome would have a disastrous impact on U.S. foreign policy and national interests, and would undermine greatly world confidence in the United States just at a time when we are striving to mobilize a cooperative global response to the challenges emerging in Southwest Asia and other regions of the world.

IV. CONCLUSION

In conclusion, Mr. Chairman, I would like to re-emphasize that the International Monetary Fund and the multilateral development banks are essential to U.S. interests.

The international monetary system is undergoing a period of major change and political strain. The IMF is our central institution for monetary cooperation and an important source of strength, stability, and broad direction as we try to contend with these changes. We need, of course, to recognize our own continuing large role in the world economy, and our responsibility for maintaining a strong U.S. economy and a sound dollar. But we need also to understand that a strong IMF role in guiding the system is of direct importance to our own efforts to strengthen the economy and maintain the integrity of the dollar. In strengthening the IMF, the United States will be making an important contribution to an international environment which greatly facilitates effective foreign policy.

We will also be strengthening a source of balance of payments financing on which we can and do draw ourselves.

U.S. national interests clearly require that we maintain a reasonable program of foreign assistance. Such a program directly supports U.S. economic, foreign policy, and national security objectives which we have in the less developed countries of the world. It also directly benefits substantial numbers of the most deprived and disadvantaged people in the poorest countries. Foreign assistance is a particularly important and necessary complement to other parts of the President's budget request which have been designed to enhance the protection of our national security and foreign policy interests. We need the support of developing countries on a broad range of international issues. We cannot expect this support unless we, in turn, help address their fundamental concern of development.

The multilateral development banks are the most cost-effective instrument for promoting economic growth and political stability -- and hence U.S. interests -- in the developing world. They encourage sound national economic policies and provide an effective framework for bringing the developing countries into the open market system we espouse. Moreover, the banks give us good value for our money with U.S. budgetary expenditures multiplied many times over in actual bank lending. They benefit borrowers and lenders, developing and developed countries alike. The importance of the banks have been reinforced by the fact that recent economic difficulties have exposed a number of developing countries to serious threats of political, economic, and social instability.

These problems have a direct bearing on our national security interests. They are difficult but not unmanageable. Given a reasonable degree of international cooperation, we have the resources to assure a gradual expansion of the world economy. Healthy and growing economies strengthen the foundation of the international economic system and maintain an environment conducive to multilateral cooperation on a broad range of other issues critical to the United States.

The seriousness of the current world situation leaves little doubt about the importance of a sound international structure for dealing cooperatively with vital issues. Now is clearly the time for renewed United States leadership in support of the Fund and the multilateral development banks and of the mutually beneficial endeavors which they represent. For these reasons, the Administration urges Congress to provide the necessary funding to sustain the operations of these institutions and to encourage their pivotal role in building a cohesive and stable world.

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

FOR IMMEDIATE RELEASE March 26, 1980

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $4,000 million of 52-week bills to be issued April 1, 1980, and to mature March 26, 1981, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: (Excepting 5 tenders totaling $4,625,000)

	Price	Discount Rate	Investment Rate (Equivalent Coupon-issue Yield)
High -	85.660	14.380%	16.36%
Low -	85.543	14.497%	16.51%
Average -	85.581	14.459%	16.46%

Tenders at the low price were allotted 74%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 43,635	$ 13,635
New York	5,427,175	3,572,675
Philadelphia	4,755	4,755
Cleveland	61,165	31,165
Richmond	48,730	25,710
Atlanta	51,405	51,405
Chicago	338,770	81,690
St. Louis	47,990	26,990
Minneapolis	22,920	19,920
Kansas City	20,185	20,185
Dallas	10,160	10,160
San Francisco	339,760	120,760
Treasury	20,955	20,955
TOTALS	$6,437,605	$4,000,005
Type		
Competitive	$4,737,940	$2,300,340
Noncompetitive	272,715	272,715
Subtotal, Public	$5,010,655	$2,573,055
Federal Reserve	1,098,450	1,098,450
Foreign Official Institutions	328,500	328,500
TOTALS	$6,437,605	$4,000,005

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52-WEEK BILL RATES

DATE: 3-26-80

HIGHEST ~~SINCE~~
EVER

LAST MONTH
13.527%

LOWEST SINCE

TODAY — 14.459%
[redacted]

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

OFFICE OF PUBLIC AFFAIRS Contact: Carolyn Johnston
(202) 634-5377

FOR IMMEDIATE RELEASE March 26, 1980

TREASURY SECRETARY MILLER NAMES JOHN W. ELLIS
SAVINGS BONDS CHAIRMAN FOR THE STATE OF WASHINGTON

John W. Ellis, President and Chief Executive Officer, Puget Sound Power & Light Company, has been appointed Washington Volunteer State Chairman for the Savings Bonds Program by Secretary of the Treasury G. William Miller.

He succeeds William P. Woods, President of the Board of Directors, Washington Natural Gas.

Mr. Ellis will head a committee of business, financial, labor, media, and governmental leaders, who -- in cooperation with the U.S. Savings Bonds Division -- will assist in promoting the sale of Savings Bonds.

Mr. Ellis joined Puget Sound Power & Light Company in 1970 as Vice President-Utility Management and Chief Operating Officer, serving in that capacity until 1973. From 1973 to 1976 he was Executive Vice

(over)

President and Chief Operating Officer. He was named to his present position January 30, 1976.

Mr. Ellis' directorships include the Overlake Hospital, Pacific Science Center Foundation, National Conference of Christians and Jews and Edison Electric Institute. He is Chairman of the Association of Washington Business Natural Resources Council.

Mr. Ellis has a BS and Juris Doctor degrees from the University of Washington. Prior to joining the Puget Sound Power & Light Company he worked with Perkins, Coie, Stone, Olsen & Williams.

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

For Release Upon Delivery
Expected at 9:30 a.m.

STATEMENT OF
DANIEL I. HALPERIN
DEPUTY ASSISTANT SECRETARY (TAX LEGISLATION)
DEPARTMENT OF THE TREASURY
BEFORE THE
HOUSE COMMITTEE ON SMALL BUSINESS
March 27, 1980

Mr. Chairman and Members of the Committee:

I am pleased to appear this morning to present the views of the Department of the Treasury on the income tax provisions of H.R. 5607, the "Small Business Innovation Act of 1979."

First, I would like to assure you that the Treasury Department shares your concern as to the continued vitality of small business. All of us, I am sure, strongly believe that the small business sector is essential to the maintenance of an innovative and competitive American business community.

In evaluating income tax provisions intended to aid small business, the Treasury's perspective may be summarized as follows: What specific areas require financial assistance from the Federal government? How much should we spend? What are the most cost-efficient means of providing that assistance -- that is, for every dollar of the public's money spent on a tax subsidy, what amount of public benefit can we expect? How can expenditures best be directed and monitored? Can the assistance be provided without damaging the equity and fairness of our self-assessment tax system? These are the tax policy questions which I know this Committee wishes to

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address, particularly in light of the need for fiscal responsibility by government and the private sector in today's difficult economic conditions.

I will now address the eight specific tax proposals contained in Title II of H.R. 5607.

1. Section 201 of the bill provides for the deferral of recognition of capital gain on the sale of an equity interest in a small business concern, provided the sale proceeds are "rolled over" and reinvested within 18 months in another small business. This provision applies to all "small businesses" as defined under the Small Business Act.

The Treasury Department opposes any such "rollover" proposal, for the following reasons:

- Rollover is not an economically efficient incentive for increasing the flow of new equity capital to small business. This is because the probabilities that a new venture will succeed and that a successful investor will wish to "roll over" his appreciation into yet another untried company in order to defer payment of capital gains tax, are together very low. Thus, the tax subsidy will not be cost-effective in creating new capital. Instead, the tax subsidy will go primarily to those lucky few who have already made a successful investment and to venture capitalists who will probably make many of the same investments without the added tax incentive.

- Rollover increases tax inequity by increasing the already substantial tax advantages of passive holding of property as compared to earning income such as wages.

- Rollover presents very complex accounting problems relating to multiple sales and reinvestments in the same period.

- Rollover in fact does not provide deferral, but instead results in complete exemption of capital gains. As a result of the expected repeal of the 1976 reform provision for carryover basis at death, the tax basis of property will be increased at death, and both the original investor and his heirs will avoid <u>any</u> income tax on appreciation.

- Rollover of small business investments is an undesirable precedent, which may lead to proposals for rollover of marketable securities and liberalized rollover of real estate.

- Finally, as this Committee is well aware, the definition of what constitutes a "small business concern," deserving of special assistance, is a very difficult and controversial matter. The difficulty and complexity of providing an equitable and even-handed approach covering all industries cannot be easily resolved. Adding this complexity to our tax Code is surely not the best way to assist small business taxpayers who are already burdened by a complex and technical statute. The problem of defining "small business" exists, of course, throughout Title II of the bill.

2. <u>Section 202</u> of the bill restores the availability of "qualified stock options" for a "qualified" small business concern -- <u>i.e.</u>, defined in the bill as a small business whose research and experimental expenditures exceed 3% of gross income for each of three consecutive years or 6% for any one year.

Present law permits both large and small employers to grant only "nonqualified" options, under which the employee recognizes taxable income, and the employer receives a corresponding deduction, equal to the bargain "spread" between the market value of stock purchased and the employee's purchase price under the option. A "qualified" option, on the other hand, permits the employee to defer paying tax until he sells the stock (assuming he holds it for three years) and then to recognize capital gain rather than compensation income. The employer is denied any deduction.

The qualified stock option was removed from the Code in 1976, primarily because Congress believed it did not provide key employees any more incentive than other forms of compensation and, in any case, because it should not be taxed more favorably than other compensation.

This rationale is correct, since employers can provide the benefits of a qualified option in another way under present law. This can be done by giving an employee a nonqualified stock option together with a cash stock appreciation right ("SAR"). For example, suppose an employee is given a nonqualified option and an SAR at $10 per share, and the employee exercises when the stock price is $30. He pays $10 for stock worth $30 and receives $20 in cash from the company under the SAR. His taxable income is $20 on the stock plus $20 of cash (total $40), on which he pays a maximum of $20 tax (50% maximum rate). Since the cash received for the SAR covers his tax liability, the employee is in exactly the same economic position he would have been in if he had received a qualified option and no SAR. In fact, he is better off tax-wise, since his tax basis in the stock is $30 in the nonqualified case but only $10 in the qualified case.

This added benefit to the employee does cost the company a small amount. Under the SAR approach, the company is out of pocket $20, but receives $10 from the employee on the option and an income tax deduction of $40 ($20 on the SAR plus $20 on the option), worth $18.40 (46% rate), for a net cash gain of $8.40. The qualified option yields the company a $10 cash gain. This $1.60 difference on $30 stock may well be worth it, considering the benefit to the employee of receiving a $20 increase in tax basis without tax cost.

Of course, some businesses may not be able to utilize fully the deduction for compensation paid when a nonqualified option is used. This problem exists for payments of cash wages, as well as SAR's and nonqualifed options. We question whether it is good tax policy to use this rationale to permit the employee to avoid accurate reflection of income and the proper tax on compensation received.

Some employers may favor the qualified option if it permits them to pay compensation without adding an expense item to the profit and loss statement. We question whether such reporting motivations outweigh good tax policy.

Accordingly, we must express serious reservations as to the wisdom of re-instituting qualified options.

3. Section 203 reduces the capital gains tax on investments in research-oriented "qualified" small businesses, held for 5 years, to 1/2 the normal tax. Here too, as in the case of rollover, the tax subsidy is inefficient, inequitable, too broad and a bad precedent. The capital gains maximum rate was reduced to 28% in 1978 and further reduction for one segment of our economy simply is not warranted at this time, particularly in light of the need for fiscal restraint.

4. Section 204 extends the period for a capital loss carryover of a corporate taxpayer from 5 to 10 years for investment losses from a "qualified" small business concern. While we are not philosophically opposed to increased carryover periods, we are troubled by the increased record-keeping and audit burdens which will be placed on the IRS and taxpayers. We are also troubled by the inequity which will be created among taxpayers with similar economic losses who will be forced to observe different carryover rules. We question whether the added complexity and inequity are justified.

5. Section 205 creates a tax-exempt "research and experimental expenditure reserve." Cash contributions to such a reserve would be deductible by a small business to the extent of the amount of its otherwise deductible research expenditures, under section 174 of the tax Code, but not to exceed the lesser of $100,000 or 10% of gross income. Distributions from the reserve would be tax-free if applied to research and experimental expenditures.

We must oppose this proposal, for the following reasons:

- A tax-exempt reserve fund is an inefficient way to provide tax subsidy assistance, because the benefits of deferral vary with the taxpayer's marginal tax rate and with the period of time during which taxes are deferred. Large businesses in the top 46% bracket will benefit more than small businesses in lower brackets. Similarly, the greatest benefits will accrue to those companies whose funds remain on deposit the longest, not those who expend the most on research and experimentation. In sum, small businesses which devote the most resources to research will benefit the least.

- Complex administrative controls would be needed. For example, extremely complex accounting would be required to define the appropriate tax treatment of taxable and nontaxable withdrawals. Presumably, Congress would wish to provide that a business which in fact made no, or only insubstantial, research expenditures from a reserve fund should not be permitted to reap any tax benefits of deferral. It would not be sufficient merely to tax non-qualified withdrawals, but instead additional complex accounting would be needed to "recapture" the benefits of deferral.

6. Section 206 would increase the permissible number of subchapter S shareholders from 15 to 100 and would permit corporations to be shareholders.

The proposed increase in the number of eligible shareholders is contrary to the original intent of the subchapter S provisions, which was to permit essentially family-owned businesses to use the corporate form without double tax. Only a very tiny percentage of truly small businesses would ever consider having more than 15 shareholders. A 100 shareholder rule will merely permit tax shelter abuses by wealthy passive investors (similar to partnership shelter syndication abuses) and will not assist the hard-working family which desires to build a business with its own efforts. Moreover, permitting 100 shareholders will create extremely difficult audit and enforcement problems for the IRS.

Permitting corporate shareholders also is clearly counter to the purpose of the subchapter S provisions, which do not envision such passive investors. Adding additional tiers of corporations would provide no benefit to the vast majority of small subchapter S companies and would be used only by the sophisticated. Finally, the corporate shareholder rule could be used to avoid the 15 shareholder limit, for example, by using several subchapter S corporations, each with 15 shareholders, to own stock in a second-tier subchapter S corporation.

7. Section 207 removes the existing dollar limitations of $50,000 and $100,000 (joint return) on losses on section 1244 small business stock for research-oriented "qualified" small businesses.

Congress looked at this area in 1978 and the limits on losses were then doubled. We question whether those limits should be removed entirely at this time.

8. Section 208 modifies the present treatment of the costs of acquiring depreciable or depletable property used in connection with research. Under existing law, such costs may be currently depreciated or depleted, even though the new property has not been used to create income-producing assets. The bill would permit immediate deduction of the cost of acquiring research equipment and would permit amortization over 60 months of the cost of all depreciable or depletable property -- regardless of the rate of amortization otherwise allowed -- except that buildings are given a 120-month period. In sum, the proposal would provide immediate expensing of research equipment and accelerated depreciation of other property, including buildings.

We cannot accept this proposal for the following reasons:

- Providing selective accelerated depreciation for only one segment of our economy will not produce more capital, but will only distort the allocation of existing capital. It may not produce more labor and materials for research industries, and hence more innovation, but only more depreciable property. In fact, the shift of resources to depreciable property may decrease expenditures for labor, and hence decrease labor-intensive innovation.

- Direct expenditure incentives are more efficient than tax subsidies, because they can be more effectively targeted and are subject to the rigorous budget process.

- These proposals will require new and very complicated technical rules, and produce many more disputes between taxpayers and the IRS, concerning the allocation of capital costs between research, on the one hand, and testing or quality control, on the other. Current law eliminates the need for such complexity and litigation, by permitting a deduction for all expenses, whether or not for research and experimentation, and denying current deductions for all capital costs.

We note that this very serious line-drawing question recurs in several sections of the bill (i.e., sections 202, 203, 204, 205, 207 and 208) which require identification of "research and experimental expenditures." Both the AICPA Accounting Principles Board and its successor as arbiter of financial accounting standards, the FASB, have concluded that this identification problem is so difficult that no financial reporting guidelines have been devised.

We agree that there is a need to take a fresh look at simplifying depreciation methods. But with today's difficult economic conditions, now is not the proper time for such proposals. Moreover, when changes are undertaken, comprehensive proposals should be considered, not just ideas for helping only one segment of our economy.

In summary, and viewing these eight proposals together, we believe that if targeted Federal assistance is needed, then non-tax direct expenditure incentives, aimed where the need is greatest, are economically more efficient and subject to tighter control through the normal budget process. Only then can inequity and distortion be kept out of the income tax system and the public's funds be spent fairly and prudently.

Our priority now is to balance the budget. Once this has been achieved, we can then proceed to consider tax relief, where it will be effective, so as to encourage investment in small business.

Mr. Chairman, that concludes my testimony. I would be happy to answer questions.

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

FOR RELEASE AT 10:15 A.M. March 27, 1980

TREASURY OFFERS $4,000 MILLION OF 80-DAY
CASH MANAGEMENT BILLS

In its announcement of March 20, 1980, the Department of the Treasury stated its intention to auction cash management bills on April 1, 1980. The auction will be conducted as scheduled but the issue date will be April 7, 1980, rather than April 4 as originally announced.

The Department of the Treasury, by this public notice, invites tenders for approximately $4,000 million of 80-day Treasury bills to be issued April 7, 1980, representing an additional amount of bills dated December 27, 1979, maturing June 26, 1980 (CUSIP No. 912793 4L 7). Additional amounts of the bills may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

Competitive tenders will be received at all Federal Reserve Banks and Branches up to 1:30 p.m., Eastern Standard time, Tuesday, April 1, 1980. Wire and telephone tenders may be received at the discretion of each Federal Reserve Bank or Branch. Each tender for the issue must be for a minimum amount of $1,000,000. Tenders over $1,000,000 must be in multiples of $1,000,000. The price on tenders offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Noncompetitive tenders from the public will not be accepted. Tenders will not be received at the Department of the Treasury, Washington.

The bills will be issued on a discount basis under competitive bidding, and at maturity their par amount will be payable without interest. The bills will be issued entirely in book-entry form in a minimum denomination of $10,000 and in any higher $5,000 multiple, on the records of the Federal Reserve Banks and Branches.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. 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.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch in cash or other immediately available funds on Monday, April 7, 1980.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, No. 418 (current revision), Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars may be obtained from any Federal Reserve Bank or Branch.

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

FOR IMMEDIATE RELEASE

Contact: Charles Arnold
202/566-2041
March 27, 1980

TREASURY CHANGES DEPOSIT REQUIREMENT FOR NON-INSTITUTIONAL PURCHASERS OF TREASURY NOTES & BONDS

Beginning with the 2 year Treasury notes to be auctioned in the latter part of April 1980, all non-institutional investors will have to submit full payment of the face amount with tenders for Treasury notes and bonds. This requirement will put payment procedures for such issues on the same basis as those currently in effect for Treasury bill issues.

Under current operating procedures, investors other than those defined as institutions by the Treasury have had the option of submitting a 5 percent deposit with note and bond tenders. This practice multiplies the processing steps and delays the issuance of the securities since the deposit payment must be processed for collection, the investor notified of the balance due, and the final payment, when made, must be matched with the tender form and then processed for collection before the security can be issued.

Institutions are defined as commercial banks and other banking institutions; primary dealers, Federally-insured savings and loan associations; States, and their political subdivisions or instrumentalities; public pension and retirement and other public funds; international organizations in which the United States holds membership; foreign central banks and foreign states; Federal Reserve Banks; and Government Accounts.

Since 1977 the number of tenders for Treasury notes and bonds has more than quadrupled. The current payment procedures have strained the ability of the Federal Reserve Banks and the Treasury to handle the increased demand, while assuring timely collection of full proceeds and issuance of the securities. The increased demand results from the significant increase in the number of individuals and other non-institutional investors participating in Treasury auctions.

Since participation by investors other than institutions is typically on a non-competitive basis, the investor is assured that the application will be accepted for the full amount requested. A recent sample of such tenders indicated that nearly 60 percent were already accompanied by full payment.

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Most Treasury bond and note auctions result in a price slightly below par, and each bidder submitting full payment will usually receive a small discount check representing the difference between the full par amount submitted and the actual price of the security, as established in the auction process. In cases in which the price is established slightly above par, investors will be billed for the additional amount due. Under the new requirement, applications submitted by non-institutional purchasers without full payment will be rejected. Personal checks will continue to be acceptable for Treasury notes and bonds.

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

FOR IMMEDIATE RELEASE March 27, 1980

RESULTS OF TREASURY'S 77-DAY BILL AUCTION

Tenders for $5,001 million of 77-day Treasury bills to be issued on April 3, 1980, and to mature June 19, 1980, were accepted at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	96.449	16.602%	17.45%
Low -	96.375	16.948%	17.83%
Average -	96.395	16.855%	17.73%

Tenders at the low price were allotted 90%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

Location	Received	Accepted
Boston	$ 84,000,000	$ 3,000,000
New York	12,112,000,000	4,367,000,000
Philadelphia	---	---
Cleveland	62,000,000	20,000,000
Richmond	94,000,000	28,500,000
Atlanta	20,000,000	---
Chicago	747,000,000	351,900,000
St. Louis	30,000,000	---
Minneapolis	15,000,000	---
Kansas City	5,000,000	4,500,000
Dallas	---	---
San Francisco	732,000,000	225,700,000
TOTAL	$13,901,000,000	$5,000,600,000

An additional $ 40 million of the bills will be issued to Federal Reserve Banks as agents of foreign and international monetary authorities for new cash.

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STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS
BEFORE THE COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

Authorization Requests for the Multilateral Development Banks for 1980

Introduction

It is a pleasure, Mr. Chairman, to appear before you today to present the Administration's proposals for U.S. participation in the replenishment of resources of the International Development Association (IDA), for membership of the United States in the African Development Bank (AFDB) and subscriptions to that institution, and for changes in the budgetary and appropriations treatment of U.S. subscriptions to the callable capital of the World Bank (IBRD) and Asian Development Bank (ADB).

The 1979 Legislation

Before discussing this bill, I want to express the Administration's appreciation for the support the Senate provided for the regional development bank authorization request last year. We are gravely concerned, however, over the threat of reductions in that authorization bill. Cuts voted in the House consisting of $1.2 billion out of $3.4 billion requested for the Inter-American Development Bank (IDB) and $265 million out of $445 million for the Asian Development Fund (ADF), would have

If the full amount requested for the IDB were not authorized, other donors would in all likelihood call for a renegotiation of the entire replenishment package. Cuts voted by the House would force out over $2 billion in other donor contributions to the replenishment, because the IDB Charter does not permit the U.S. voting power to drop below the current threshold of 34.5 percent. Moreover, given the extremely favorable results of the IDB Fifth Replenishment, from U.S. policy and budgetary perspectives, a renegotiation would not be in the U.S. interest.

As part of the Fifth Replenishment package the United States achieved:

- agreement that 50 percent of total Bank lending from this replenishment would directly benefit low income groups
- a lowering of the share of paid-in capital from 10 percent to 7-1/2 percent (saving U.S. $69 million)
- a reduction in U.S. annual contributions to the Fund for Special Operations (FSO) from $200 million to $175 million
- a substantial increase in the convertable currency contributions of the larger Latin American countries to the FSO
- a tripling of the shares of the nonregional members over their initial shares of capital

It is probable that some, maybe all, of these hard fought achievements would be lost in any renegotiation, particularly if the U.S. were to reduce substantially its total contribution. Any renegotiation would take from six months to a year, or longer, given the necessity for parlimentary approval in some member governments. In the meantime, the lending program would come to a halt.

A cessation of lending by the IDB and ADF would have serious adverse repercussions on our national security and foreign policy. Countries and regions of growing importance to U.S. national security, such as Pakistan, Central America, and the Caribbean, would be especially hard hit as a result. Obviously such action would also raise fundamental questions about the reliability of the United States in fulfilling its international commitments and this country's intentions as regards its leadership role in Latin America and Asia.

Authorization of the full amounts in the bill is entirely consistent with current efforts to achieve savings in budgetary outlays during FY1980 and FY1981. Of the $4.0 billion to be authorized, $2.5 billion -- more than 60 percent of the total request -- is for callable capital subscriptions to the IDB, which are virtually certain never to result in budgetary outlays.

For the $1.5 billion in the request which eventually will result in budgetary outlays, appropriations are being sought over the period FY1980 - FY1983. However, the budgetary impact of the drawdown of these funds will be minimal because that drawdown is tied to disbursements required to implement bank projects which take a minimum of five years to complete. We estimate that this bill will result in zero budgetary outlays in FY1980. Budgetary outlays for the total request of $4.0 billion will be less than $7.0 million in FY 1981 and less than $33 million in FY 1982. Furthermore, as agreed by the Conferees, procedures for drawdowns will be changed to delay outlays as long as possible.

For all these reasons, it is essential that the full amounts in last year's authorization request be approved.

<u>The 1980 Legislation</u>

This year's bill focuses on the poorest countries of the world. IDA recipients include virtually all countries with annual per capita incomes below $320, in addition to scattered countries with slightly higher income levels. Their total population is more than one and one-quarter billion. The AFDB lends to African countries with incomes averaging $460 per year, and with a total population of 200 million.

There should be no doubt about the overwhelming need among the prospective IDA and AFDB recipients for these programs to be undertaken during the 1980s. Not only do these countries have the lowest per-capita incomes in the world, they have also experienced the slowest economic growth in the post-OPEC era, barely outpacing population growth. On average, over one half of their populations is mired in absolute poverty where hunger, malnutrition, illiteracy, disease, high infant-mortality, and low life-expectancy are an inevitable way of life.

The sum effect of these proposals will be to provide addition lending of over $15 billion during the first half of the decade to the world's very poorest. This means new programs to increase food production and alleviate hunger, to improve health, sanitation, housing, nutrition, and education, to build critical development infrastructure, and to limit burgeoning population growth.

Channelling assistance through the multilateral development banks (MDBs) has the advantage of complying fully with our domestic requirements for budget stringency. U.S. participation in the MDBs is the most cost-effective approach available to providing substantial amounts of development assistance to the Third World. Enormous fiscal advantages derive from our MDB participation because the burden for providing development assistance is shared with other countries, because the MDBs leverage our paid-in contributions through borrowings in world private capital markets, and because the MDBS, through increased purchases of U.S. goods and services, return substantial economic benefits to the U.S. economy -- including additional tax receipts which nearly offset U.S. budgetary outlays.

Furthermore, international burden-sharing through the banks is becoming more equitably and widely spread. The U.S. share in nearly every MDB in which the United States is currently participating has declined in recent years, while the lending levels of these institutions have increased. Other donor countries now contribute 75 percent of total MDB resources. Moreover, increasing amounts of our contributions are provided via callable capital, not a penny of which has ever left or is likely to ever leave the U.S. Treasury.

Burden-sharing, use of callable capital and the return of economic benefits to the U.S. economy provide a cost-effective combination to reconcile the need for a substantial, viable foreign assistance program with our current requirement for fiscal austerity. Through that combination, for example, the World Bank can now lend approximately fifty dollars for each dollar paid-in by the United States at no net cost to the U.S. taxpayer. Although the concessional MDB institutions such as IDA, where there is no callable capital, do not provide this leverage, major cost-effective advantages -- through burden-sharing and greater tax receipts via expanding U.S. exports -- accrue to the United States.

The authorization request for the United States' share of the Sixth Replenishment of IDA (IDA VI) totals $3.24 billion. The Sixth Replenishment will provide IDA with $12 billion in new resources for lending on concessional terms, over the period FY1981-FY1983, to the world's poorest countries. IDA VI cannot become effective without the participation of the United States.

This bill also would authorize United States membership in the African Development Bank, which for the first time will open its doors to nonregional members, thereby broadening the Bank's financial base, enhancing its access to private capital markets, and thus contributing more effectively to Africa's development. In conjunction with nonregional membership, the capital of the AFDB will be increased from $1.5 billion to $6.3 billion to support a lending program for a minimum of five years.

The proposed U.S. subscription to the AFDB would total $359.7 million, or 5.7 percent of the Bank's total capital. This share is sufficient to allow the United States to elect an Executive Director to the Bank Board. Twenty-five percent of the U.S. subscription, or $89.9 million, would be paid-in. The remainder would take the form of callable capital.

The Multilateral Development Banks in the 1980s

It is the view of the Administration that active, undiminished U.S. support for the multilateral development banks throughout the 1980s will be critical to fundamental U.S. economic, political, and security interests. Those interests include:

-- national security.

The banks comprise an important part of the international institutional framework which the United States must rely upon to enhance world security. The United States was the principal architect of that framework and recent events in Southwest Asia have demonstrated its importance to a secure, stable world environment. U.S. security interests are so far-reaching that defense of those interests would be unthinkable without relying upon the multilateral process through the existing institutional framework. The responses of the United States to the crises in Iran and Afghanistan and the results of those collective, collaborative efforts with much of the developing world, have demonstrated the importance of the multilateral process in promoting our foreign policy and national security interests. The United States must therefore give its fullest support to the process in order to keep it working to support U.S. interests.

In support of collective security action, the banks are critical to the maintenance of political stability in each of the major regions of the world and in key countries. One need only scan the list of the largest MDB borrowers -- Mexico, Brazil, India, Korea, Pakistan, Egypt, Indonesia, Colombia, Yugoslavia, Kenya and Turkey -- to grasp the importance of the MDBs to U.S. security by way of their contributions to growth and material well-being, and thus to political stability in key regions of the world.

Finally, there is the growing importance of U.S. dependence on critical raw materials from the developing world. The United States is nearly totally dependent upon the developing countries for supplies of bauxite, tin, manganese, and natural rubber, as well as certain food-stuffs. The United States and the rest of the Western World have a vital stake in promoting the stability and growth of the economies of developing countries which produce critical new materials and in retaining access to these supplies.

-- <u>the health of the international economic system</u>.

In 1979, MDB loan commitments totalled nearly $14 billion. This represents by far the largest official source of external capital for the developing world. As such, the MDBs contribute in a major way to economic growth and stability in recipient developing countries and in rapidly expanding trade between the Third World and the developed countries. In providing dispassionate policy advice, in preparing development projects based upon objective economic criteria, and in insisting upon rational economic policies within recipient countries, the MDBs are an important, respected force for the maintenance of an efficient, responsive international market economy. The impact of the banks in this regard, and their resulting contribution to the health and resilience of the world economy, is often overlooked but cannot be overstated.

Another intangible is the inducement of the banks to cooperative efforts among developed and developing countries, where relations in the recent past had too often been characterized by confrontation and hostility, to resolve pressing international economic problems. Cooperation here means developed and developing countries working together to focus bank policies and resources to respond to critical world needs. Most recently, this has meant both shifting MDB lending away from traditional infrastructure to agriculture and rural development to more directly benefit the poor and to increase food production, and greatly expanding lending to increase developing country energy production.

The banks also contribute to the effort to recycle funds from the oil producing countries to the developing world. Recent oil price increases will add about $14 billion to the current account deficits, totaling approximately $50 billion, for the oil-importing developing countries this year. Though the basic objective of bank loans is to promote long-run development in recipient countries, their role in this regard will become more prominent and vital to the world economy in the 1980s.

-- <u>direct U.S. economic benefits</u>

The most rapidly growing developing countries which, not coincidentally, are among the largest MDB borrowers, are also the most rapidly growing export markets for the United States. Generally, non-oil developing countries account for about 25 percent of U.S. exports, including one-quarter of U.S. manufactured exports

These markets have become more important to U.S. trade than the entire European Community.

Through the contributions of other MDB donors, which on average comprise 75 percent of the total, and through the use of callable capital, MDB loans result in expenditures on U.S. goods and services well in excess of U.S. contributions to the banks. From the inception of the banks through 1978, the cumulative current account surplus for the United States directly attributable to MDB activities (the purchase of U.S. goods and services, net interest payments to U.S. MDB bondholders, and MDB administrative expenses in the United States), has been $11 billion. Cumulative U.S. paid-in contributions to the banks, by comparison, totaled $7 billion. This means that every dollar contributed to the MDBs results in $1.57 being injected directly into the U.S. economy.

The total economic effects, however, are much larger and more broadly based than the effects directly observable from our balance of payments. That $1.57 becomes the income of a U.S. exporter, bondholder or Bank employee residing in the United States. It is in turn respent, resulting in multiple increases in U.S. national income, employment, and Federal Government and local tax receipts.

Treasury analysis shows that over the period 1977-1978 every dollar contributed to the MDBs has resulted in an increase of U.S. GNP of $3.00. This three for one multiplier effect is sizable and stems, in part, from the unique characteristics of the MDBs, i.e., their multilateral character which provides for other donor country contributions and the availability of callable capital which permits substantial borrowing on private capital markets. Total U.S. GNP growth directly attributable to MDB activities averaged $2.7 billion over 1977-1978, raising net Federal tax receipts by $720 million annually and reducing the net cost to the Federal budget for our participation in the banks to $170 million each year. If increased local tax receipts were included the net cost to the American taxpayer probably would be minimal.

Developing Country Prospects for the 1980s

The record for the developing countries over the past two decades, which spans the work of the MDBs including IDA, shows clear progress. During the decade of the 1960s and up to the 1974 surge in OPEC oil prices, gross domestic product for the developing countries grew at six percent or more annually, exceeding growth in the industrialized countries. Developing countries' exports of manufactured goods grew at nearly 13 percent annually and their share of total world manufactured exports grew from six percent to ten percent during that period.

Moreover, each of the quality-of-life standards -- life expectancy, infant mortality, literacy, access to potable water and calories as a percent of daily requirements -- showed significant improvements during the 1960s and 1970s and a narrowing of the gap with the industrialized countries. Average per-capita income for the developing countries also has approximately doubled in real terms since 1960.

Despite recent progress in many areas, the prospects for the developing countries in the 1980s are not optimistic. In part this is because the world economy has moved haltingly, at best, to recover from the oil price increases and subsequent recession of the mid-1970s, and because the recovery remains far from complete. Thus, for the 1970s, while the per capita GDP of the major oil exporting countries grew at 6.6 percent per annum, per capita income grew at 3.6 percent for the middle income developing countries and fell off to only 1.7 percent per year for the poorest developing countries. For the poorest countries in Africa per capita growth was an imperceptible 0.2 percent.

In large part these meager results reflect a general slow-down in growth throughout the developing world in the 1974-1979 period. The causes of that slow-down -- surging oil prices, worldwide inflation, slower growth in the industrialized countries, and declining real supplies of external capital -- cast long shadows over prospects for the 1980s.

Under the most optimistic assumptions of vigorous economic growth in developing countries in the 1980s, the World Bank has projected that their per capita income will increase 4.2 percent per annum. However, per capita income would increase by only 3.5 percent in the poorest developing countries and under 2 percent in Sub-Saharan Africa. Under more realistic assumptions, the per capita income of the developing countries can be expected to increase at an average rate of between 2.4 percent and 3.3 percent, but at only one percent or less in the poorest countries of Africa and under three percent in the low-income Asian countries.

Hence, per capita income in the poorest developing countries, with a billion and a quarter people, will probably increase only

$1-$10 per year over the next decade. The World Bank also estimates that, realistically, we can only expect to reduce the numbers of people living in absolute poverty -- that bare survival state conditioned by malnutrition, illiteracy, disease, high infant-mortality and low life-expectancy -- from 800 million to 600 million by the end of the century.

Equally disturbing is the fact that, while developing country food production is barely keeping abreast of overall population growth, in the poorest developing countries population growth at 2.4 percent a year has been outpacing food production which has grown at less than one percent annually since 1961. The combined effects of poverty and food insecurity, neither of which is being ameliorated in the poorest countries, are interacting to cause a worsening problem of hunger. Millions of people --more than three-quarters of whom live on the Indian subcontinent, in Southeast Asia and in Sub-Saharan Africa -- are afflicted by hunger. Short of a massive effort at increasing food production in the poorest developing countries themselves, this condition will remain widespread throughout the 1980s.

The Role of the Multilateral Development Banks and U.S. Objectives in the 1980s

These somber prospects have led us to conclude that the multilateral development banks must play a major world-wide development role in the 1980's. The MDBs have the technical expertise and the experience to use the capital resources which we propose to provide them for the coming years. Moreover, they do so in an extremely cost-effective manner through the sharing of the burden of foreign assistance with other donor countries and long term borrowing on capital markets with the backing of callable capital, at minimum cost to the U.S. taxpayer.

The MDBs are the most efficient, effective instruments to pursue broad-based development strategies in the developing world. At the micro-economic level, they follow detailed and rigorous loan appraisal processes to ensure that every dollar of development lending yields maximum benefits. Loan analysis is performed solely on the basis of relevant economic and technical considerations. Their apolitical nature also carries with it a special trust which enables the staffs of MDBs to influence strongly borrowing countries in the adoption of sound policies.

The United States also has significant policy leverage in the banks relative to both the proportion and dollar amounts of its contributions. Over the recent past, the United States has pursued a number of policy objectives in the MDBs to promote further their objective of helping the developing countries attain higher standards of material well-being and to help alleviate the conditions of absolute poverty. Among these objectives have been to reach the poor more effectively and efficiently, to increase food production substantially, and to increase both the the amounts and proportion of lending for projects designed to increase world energy supplies.

In response to U.S. urging, all of the MDBs have redirected the sectoral composition of their lending better to meet basic human needs and to ensure that proportionally more project benefits flow to lower income groups in borrowing countries. This redirection is reflected in the rapid growth of lending for agricultural projects.

World Bank Group lending for agriculture, one third of which is coming from IDA, has increased 145 percent in the past five years. For IDA alone, loans for the agricultural sector have grown by 427 percent. During that period, IBRD/IDA activities have provided the base for producing one third of all increased fertilizer production in the developing countries for the first half of the 1980s, one fifth of the total investment in rural road networks in developing countries, and one quarter of total public investment in developing country irrigation systems. Furthermore, 358 IBRD/IDA agricultural projects over these past five years have had the rural poor as their principal beneficiaries, and an estimated 60 million of the 100 million direct beneficiaries of these projects had incomes below the absolute poverty levels in their respective countries.

Currently, approximately 46 percent and 30 percent of IDA and IBRD lending, respectively, flows to the agricultural sector, up from 37 percent and 11 percent respectively in the early 1970s. Over 75 percent of combined IBRD/IDA agricultural assistance is now directed towards expanding food production. As noted in the forthcoming report of the President's Commission on World Hunger, the World Bank Group is the world's largest single source of external funding for developing world agriculture. The World Bank expects to finance projects which will contribute up to 20 percent of the increase in annual food production in its developing member countries in the 1980s. It is due to this effort that the President's Commission on World Hunger has concluded that the United States should strongly support the activities of the MDBs including an increase in U.S. contributions to the concessional windows of the banks.

An important means to implement the objective of more effectively and directly reaching the poor has been to encourage greater utilization of capital saving technologies. Such technologies have the advantage of increasing the productivity and incomes of poor people at low per capita costs by insuring that the maximum numbers of people benefit from MDB projects and by promoting the most efficient use of factor availabilities. The United States has sought greater utilization and development of capital saving technologies in the MDBs by encouraging policy decisions in the banks, urging increased MDB staff focus on the appropriateness of technologies, and constantly reviewing project loans to assure improved application.

The United States has also been at the forefront in urging the MDBs to adopt a comprehensive energy program. In the World Bank Group in January 1979, the Board of Executive Directors approved an expansion of the IBRD/IDA energy program. That program is now planned to grow to at least 15 percent of total Bank lending within five years.

Over the 1980-84 period, the World Bank Group will lend $7.7 billion for the exploration, production, and development of oil, gas, and coal, and for the construction of new hydroelectric facilities. The loans will be combined with approximately three times as much private and government financing. When the projects are in operation, they will produce additional primary energy fuel in oil importing developing countries estimated to equal between 2 and 2.5 million barrels a day of oil. This should help to increase world supply and thereby reduce pressures on world oil prices, as well as deal directly with one of the most critical bottlenecks to development.

The International Development Association

The International Development Association (IDA) is central to the attack on poverty in the poorest countries in the world. The record of that institution demonstrates clearly that developed and developing countries can work successfully to resolve common problems. Rhetoric and confrontation have no part to play in IDA programs. IDA recipients have come to appreciate and depend upon concrete development projects and programs which are designed to resolve real economic problems and to produce material improvement in the lives of their people.

It is important that the United States strongly support cooperative programs for mutual gain such as IDA. It serves to undermine those in the developing world who favor confrontation with the United States, to preempt proposals in North/South fora which are adverse to U.S. economic and political interests, and to enhance prospects for developing country support on issues of primary importance to the United States. At a time when global economic difficulties are exposing nearly all of the poorer developing countries to serious threats of political, economic, and social instability, IDA is making an invaluable contribution to our national security and other U.S. foreign policy objectives, via the multilateral process.

The rather bleak prospects for the low-income countries of Africa and Asia give IDA a vital development role to play in the 1980s. IDA is the largest source of concessional resources in the world, the largest source of external financing for the countries of Africa, and the centerpiece of multilateral efforts to utilize concessional resources effectively within broad-based development strategies. As such, it will be the major hope for the poorest developing countries and their one and one-quarter billion people over the next decade.

IDA will be crucial in determining whether per capita food production in the poorest LDCs will increase and whether real progress is made in alleviating world hunger. Nearly two-thirds of the external financing requirements of the low income developing countries will need to be met through disbursements of concessional capital, of which IDA will be the largest single source, during the last half of the 1980's. IDA will be key in determining whether the more than 800 million persons mired in absolute poverty can be significantly reduced by the end of this century. It will depend largely upon IDA as to whether the poorest developing countries will be able to undertake programs to improve education, health, sanitation, housing, nutrition, and population control throughout the 1980's.

About 90 percent of IDA lending goes to countries with annual per capita incomes below $320 (1978 dollars). None of IDA's recipients has a per capita income above $625. The 54 current IDA borrowers account for approximately 31 percent of the world's population, but only three percent of global gross national product. Average life expectancy in these countries is about 50 years, the adult literacy rate is 36 percent, and the labor force is expanding at two percent per year. Most of these countries are in South Asia and in Sub-Sahara Africa, two regions which borrowed 80 percent of IDA resources in FY1979. IDA's lending policy also focuses on development projects which reach the lowest 40 percent of the income earners within the recipient borrowing countries.

All IDA credits to date have been for a term of 50 years. After a 10-year period of grace, one percent of the credit is repaid annually for ten years, while in the remaining 30 years, three percent is repaid annually. There is an annual service charge of 0.75 percent on the disbursed portion of each credit to cover administrative costs. All credits are repayable in convertible currency.

During 19 years of operations through June 30, 1979, IDA has made development credits aggregating $16.7 billion to 74 countries. There has never been a default on an IDA loan by any borrower.

IDA VI Replenishment

A major step in assuring that IDA will be adequately financed to carry out its current task in the 1980s is the agreement which has been reached on a $12 billion replenishment of IDA for lending over the years FY1981 through FY1983. The proposed Sixth Replenishment will enable IDA to expand its lending from an average of $3 billion per year during IDA V, to $3.5 billion in FY1981, $4.0 billion in FY 1982, and $4.5 billion in FY1983. The $12 billion IDA VI replenishment represents a real increase of only 4.5 percent over IDA V, the minimum considered necessary to spur additional growth in the poorest developing countries. The increase in IDA VI is far below those of previous IDA replenishments.

It must be noted that IDA VI cannot become effective without full U.S. participation. Unless additional funds become available, the Association will exhaust its commitment authority by June 30, 1980, with drastic consequences for the poorest, most populous countries of the world.

The IDA VI negotiations were protracted and difficult. On the one hand, it was widely recognized that the needs of the poorest developing countries are immense and growing and that growth among a number of the countries had been stagnating in recent years. As a result, the World Bank originally proposed a replenishment of $15 billion. On the other hand, a number of donors, including the United States, faced severe budgetary constraints. These opposing views eventually reached a compromise agreement for a $12 billion replenishment despite the views of a number of donors that the urgency of the poverty problem among the poorest developing countries demanded a larger replenishme package. Nevertheless, the agreement reached will permit a 4-5 percent annual real growth in IDA lending over the period, FY1981-FY1983.

The U.S. share of IDA VI will be 27 percent, sharply lower than the 31.04 percent U.S. share of IDA V. The U.S. decline will enable the level of the U.S. contribution to show no real growth relative to IDA V -- total lending will rise 4-5 percent while the U.S. share declines by 4 percent. The U.S. share will total $3.24 billion, or an annual U.S. contribution of $1,080 million. The full U.S. contribution must be authorized. Otherwise the United States could not participate in the replenishment and IDA VI, which took more than a year to achieve, would have to be renegotiated. In the interim IDA lending would cease.

It was through improved burdensharing in IDA IV that a modest real increase in IDA's development resources will be achieved. The large reduction in the U.S. share was offset by substantial increases in the shares of Germany (from 10.9 percent to 12.5 percent) and especially Japan (from 10.3 percent to 14.7 percent). For the first time in an IDA replenishment the combined shares of these two countries will exceed that of the United States. Six members mostly developing countries, including Mexico, Argentina and Brazil, will provide IDA with resources for the first time. These burdensharing achievements were explicit negotiating objectives of the United States under the mandate of the Congress to reduce significantly the U.S. share in IDA.

Other negotiating accomplishments included agreement that:

-- Energy lending would expand rapidly during IDA VI, thus increasing world supplies and helping to ease upward price pressure.

-- IDA's major thrust would continue to be in reaching the poor. The proportion of IDA lending to agriculture and rural development would expand through FY1983. Lending for the urban poor would also increase.

-- Supervision and evaluation of IDA projects would be stepped-up using standards and procedures set out in detail during the negotiations, thereby enhancing the operating efficiency of what is universally recognized as a superbly run institution.

Replenishment of IDA, as agreed in these negotiations, is essential if the poorest developing countries are to have any prospect of achieving meaningful growth in the 1980s. IDA VI is also necessary if we are to move toward alleviating world hunger, and reducing absolute poverty during the decade. It will make an important contribution toward meeting worldwide energy needs in the coming years. Finally, the continued strong presence of IDA throughout the poorest regions of the Third World will be critical to the maintenance of political and economic stability, and ultimate peace. We could pay a heavy price by its absence.

U.S. national interest dictates that we fully support this replenishment of IDA.

United States Membership in the African Development Bank

Development performance in Africa throughout the 1970s has been particularly disappointing. For the poorest countries - the bulk of the countries in Sub-Saharan Africa - per capita income growth for the decade averaged 0.2 percent per year. This means tha throughout the 1970s much of the population of Sub-Saharan Africa increased their incomes by less than one dollar per year. The "middle income" countries of Sub-Saharan Africa with an average annual per capita income of $460 fared little better. Per capita income for these countries increased at 1.4 percent per year, the lowest growth rate of any region of the world, including

Furthermore, prospects are that per capita income growth will continue to either stagnate or improve imperceptibly throughout the decade of the 1980s. The World Bank projects an annual increase of between 0.7 and 1.9 percent for the poorest African countries and between 0.7 and 2.2 percent for the "middle income" countries, depending upon low or high growth assumptions.

Even such per capita income growth notions fail to reflect the immense development problems facing the developing countries of Africa in the 1980s. These countries have the lowest literacy rates, the lowest life expectancies, the highest population growth rates, and the largest percentage of people living in absolute poverty of any major developing region on the globe. This is somewhat ironic given that Africa is perhaps the richest of the developing country continents in natural resources - with large sources of bauxite, oil, potential hydroelectric power, manganese, copper, precious minerals, and vast potential for agricultural production.

It is concern over the development prospects for the countries of Africa, our common cultural heritage with the Sub-Saharan countries and the long-standing policy of this Administration to expand and strengthen U.S. ties with Africa that has resulted in our proposing U.S. membership in the African Development Bank (AFDB).

The AFDB was established in 1964, to lend at near-market terms for the economic and social development of its African members and to promote regional cooperation. To meet the challenge of Africa's poverty, loans are provided primarily to strengthen the agricultural sector and to finance critically needed infrastructure. The AFDB's lending activities are financed through member country paid-in capital subscriptions and borrowings in international capital markets.

While the United States and other nonregional countries are members of the AFDB's concessional loan affiliate, the African Development Fund, membership in the Bank to date has been restricted to African nations. The limited capital resources of its African members have severely restricted the AFDB's lending program and its access to private capital markets.

Consequently, in May 1979, the Governors of the AFDB invited nonregional countries to join their institution. Nonregional membership will expand and diversify the Bank's financial base and greatly enhance its access to private capital markets. As a result, the Bank will be able to increase its lending program substantially over the next five years and contribute more effectively to development, of the continent.

Results of the AFDB Negotiations

Active United States participation in the nonregional membership negotiations and support for U.S. membership in the AFDB were based on numerous U.S. interests which Bank membership would serve. The United States has rapidly expanding economic and political interests in Africa which would be furthered by supporting the continent's development through the AFDB.

In addition, United States membership in the African Development Bank was seen as another means to concentrate increasing development assistance on the poor. Most of the countries which are "middle income" for Africa -- and thus receive nonconcessional AFDB loans -- are at a level of development far below that of the "middle income" countries of other regions. The middle income countries of Sub-Saharan Africa have an average per capita income of $460 compared to $990 in other developing regions.

The multilateral character of the AFDB would provide a firm basis for sharing the cost of Africa's development with other countries. In the 1960s, the United States had already entered into similar multilateral partnerships with the nations of Latin America and Asia through the Inter-American Development Bank and the Asian Development Bank. Participation in the AFDB would complete this series of partnerships in an established and recognized pan-African institution.

In addition, by financing the basic infrastructure needs of African countries (roads, power, water supply, and sewerage) and agricultural projects, the Bank would complement increasing U.S. bilateral assistance efforts in Africa which focus more on meeting basic human needs. The AFDB would also complement IDA's activities by directing two-thirds of its lending to African countries with annual per capita incomes between $320 and $700, while IDA concentrates its resources on those African nations with less than $320 per capita.

In conjunction with the entry of nonregional members the capital of the Bank will be increased from about $1.5 billion to $6.3 billion, over a five year period. Of this increase, the regional members would provide 57 percent or $2.8 billion. The 21 nonregional countries seeking membership -- the countries of Western Europe, Canada, Japan, Korea, Yugoslavia and Kuwait as well as the United States -- would subscribe $2.1 billion. Twenty-five percent of the increase, or $1.2 billion, will be paid-in capital with the remaining seventy-five percent ($3.6 billion), in callable capital.

The proposed U.S. subscription would total $360 million -- 5.7 percent of the Bank's total capital and 17 percent of the nonregional share. The U.S. nonregional share is equivalent to the U.S. share of the current replenishment of the African Development Fund. This share represents an effort to balance our interest in increased burden-sharing with other donor countries with our desire to become more actively involved in the economic and social development of Africa.

In order to accommodate adequate representation on the Board of Directors by the nonregional countries, the Board will be expanded from the current nine to eighteen members. Twelve Directors will be elected by the regional members and six by the nonregional members, reflecting the proportional participation of each group in the capital stock of the AFDB. The size of the proposed U.S. share of AFDB capital will enable the United States to elect an American as Director to the Bank's Board.

U.S. membership in the AFDB comes at an opportune time. It is fitting that the United States should join a major pan-African institution, as the largest nonregional member, during a period when our overall relations with the nations of Africa have experienced dramatic improvement. The Sub-Saharan region remains politically volatile and the rapid expansion of the AFDB will help to stabilize the region by strengthening the healthier independent African nations, promoting pan-African cooperation, and assisting the region to evolve peacefully toward full political autonomy.

Finally, recent poor growth performance of the middle-income African countries and cloudy prospects for the 1980's show the necessity for a sizeable expansion of the African Bank's lending program. These countries have a critical need to diversify their economies: low growth projections for the 1980's are due, in large part, to the high share of slow growing primary products in their exports which will limit overall export expansion. Furthermore, many of these countries, including Kenya, Ivory Coast, Morocco, Nigeria and Gabon, among others, have demonstrated rapid development potential and the capability of absorbing capital resources efficiently.

Treatment of U.S. Subscriptions to IBRD and ADB Callable Capital

The Administration is also proposing amendments to those legislative provisions enacted by the Congress in 1977 which require that full appropriations be obtained prior to U.S. subscriptions to the Selective Capital Increase of the IBRD and the Second Capital Increase of the ADB. Under the proposed amendments, subscriptions to IBRD and ADB callable capital stock could be made after program limitations on the subscriptions are enacted in the Foreign Assistance Appropriations Act, rather than actual appropriations.

The proposed amendments would make consistent the statutory terms under which the United States can subscribe to IBRD and ADB callable capital stock with the terms provided in the authorizing legislation for the proposed replenishment of the IDB, as well as with the provisions in this bill for initial subscriptions to the capital stock of the AFDB. The amendments are essential to allow implementation of the President's FY 1981 Budget which proposes enactment of program limitations in the FY 1981 Foreign Assistance Appropriations Act for U.S. subscriptions to callable capital stock in the MDBs, including the IBRD and ADB.

The change in the treatment of callable capital is being proposed because the appropriation for the full amount of callable capital and the resulting scoring of the appropriated amounts as budget authority distort the true size of the request for the MDBs.

The budgetary and appropriations treatment of callable capital is an issue that has been under intense consideration for over a year both within the Administration and between the Administration and Congress. Changing the treatment of callable capital was discussed last year during consideration of S. 662. At that time, the Committee approved language which authorized U.S. subscriptions to callable capital of the Inter-American Development Bank without requiring prior appropriations to fund these subscriptions.

The "callable capital" concept is one of the most attractive features of the multilateral development banks and results in considerable budgetary savings for the U.S. Government. With callable capital as backing, the MDBs are able to borrow most of the non-concessional funds they require in international capital markets. The cost to the U.S. Government of subscriptions to callable capital is solely contingent in nature, since callable capital can only be used to meet obligations of the MDBs for funds borrowed or guaranteed by them in the unlikely event that the banks' other resources are insufficient to meet those liabilities.

The risk of a "call" is extremely slight. The loan portfolios of the MDBs are distributed broadly, and major defaults are unlikely. Even if a number of their largest borrowers were to default, the MDBs have very considerable financial assets upon which they could draw. Moreover, prior subscriptions to individual MDBs totalling $11.5 billion have been funded by the Congress against potential U.S. liabilities, of which $8.4 billion relates to U.S. subscriptions to IBRD and ADB callable capital, the two institutions for which amendments are being proposed. In the IBRD, all prior U.S. subscriptions to callable capital have been fully funded. In the ADB, of the $736 million in U.S. subscriptions to callable capital, all but $126 million has been appropriated.

It is therefore virtually certain that there will never be budget outlays resulting from U.S. subscriptions affected by these amendments. Thus, as in other donor countries, we propose to cease treating callable capital subscriptions as though they would have an outlay impact, when that is not the case.

Conclusion

There is a very real need for continued growth in IDA lending, and for a strengthening and expansion of the African Development Bank's activities in the 1980s, as provided in this bill. Together, these proposals will act to improve materially the lives of one and a half billion of the world's poorest people, residing in the world's poorest countries.

The Sixth Replenishment of IDA is essential if the poorest countries, in the 1980s, are to increase per capita income levels meaningfully, reduce the numbers of people living in absolute poverty, make progress toward alleviating world hunger, continue to narrow the gap with the middle-income and developed countries in life expectancy, literacy and infant mortality, build the basic infrastructure required for development, and meet their energy needs.

U.S. membership in the AFDB and expansion of that institution's capital base are required to promote economic progress in Africa, expand U.S. economic and political interests there, and solidify recent improvements in U.S. relations with a large number of African nations.

Continued emphasis on the MDBs to channel an increasing proportion of U.S. development assistance is fully consistent with our domestic concerns over cost-effectiveness and fiscal austerity. The MDBs allow us to reconcile the overwhelming need for a viable development assistance program throughout the 1980s with the pursuit of a tough domestic anti-inflation program, because they provide enormous fiscal advantages. These include burdensharing of development assistance with other countries, the leveraging of U.S. contributions through borrowings in world capital markets and purchases of U.S. goods and services which return substantial economic benefits including increased tax receipts which nearly offset U.S. budgetary outlays for our participation in the banks.

I strongly urge your support for U.S. participation in the Sixth Replenishment of the International Development Association, for U.S. membership in the African Development Bank, and for changes in the budgetary and appropriations treatment of U.S. subscriptions to the World Bank and Asian Development Bank callable capital.

Department of the TREASURY NEWS
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FOR RELEASE UPON DELIVERY
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STATEMENT OF THE HONORABLE DONALD C. LUBICK
ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
ON H.R. 5076

Mr. Chairman and members of this Committee:

I am pleased to have the opportunity to appear today to present the views of the Treasury Department on H.R. 5076 which would clarify the extent to which a state, or political subdivision, may take account of certain income from sources outside the United States in imposing its income taxes.

H.R. 5076 has two distinct parts, one dealing with state unitary apportionment taxation systems as applied to foreign corporations and the other dealing with state taxation of dividends received by a corporation from a foreign corporation.

Under unitary apportionment systems as applied in several states, the income of a corporation doing business in the state is determined for state income tax purposes by applying a formula taking account of the income, payroll, property, and sales of the corporation subject to tax and all related corporations which are considered part of a unitary business (*i.e.*, whose activities are dependent upon or contribute to the business of the corporation

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whose income is being taxed). No distinction is made, in some states, between U.S. and foreign corporations or between corporate groups controlled by U.S. corporations and those controlled by foreign corporations. The first part of H.R. 5076 is aimed at the practice of including foreign corporations in the unitary apportionment system.

This practice creates three types of problems: (1) It can result in a determination of income for state tax purposes which is substantially different than the income which would be attributed the corporation doing business in the state if an arm's-length or separate accounting method were used. To the extent that the relationship between the three apportionment factors (payroll, property, and sales) and the income to be apportioned differs markedly in foreign countries from the relationship which generally applies within the United States, the measurement of income by this method can result in serious distortions. In practice, the unitary apportionment system appears in comparison to an arm's length or separate accounting method to generate substantially more taxes for the states. (2) The practice can impose a substantial administrative burden, involving annual translation of the books of what may be a substantial number of foreign corporations into U.S. accounting concepts and U.S. currency. (3) The practice has created, and continues to create, an irritant in the international relations of the United States. A number of foreign governments have complained, both officially and informally, that the unitary system differs from the arm's-length method used by the Federal Government and generally accepted in international practice.

The first part of the bill, reflected in paragraphs (a) through (d) of a proposed new section 7518 of the Internal Revenue Code, would prohibit any state or political subdivision, in imposing tax on any corporation, from taking into account in its unitary apportionment formulas the income of any foreign corporation which is a member of an affiliated group including the foreign corporation and the corporation subject to tax, unless the income of "the corporation" (presumably the foreign corporation) is subject to Federal income tax.

Although the bill makes no distinction between corporate groups under United States control and those under foreign control, such a distinction may be warranted. Of the three types of problems created by the international application of unitary apportionment, only the first--the potential for a distorted measurement of taxable income--applies fully with respect to U.S. based multinational groups. U.S. parent corporations are already required to submit financial statements to the IRS annually with respect to their overseas subsidiaries. Thus, the administrative burdens which the unitary system creates for foreign based corporate groups are not present to the same degree for a group controlled from the United States. Similarly, the application of a unitary system to U.S. controlled corporate groups represents much less of an international irritant, if in fact that problem is present at all.

The Treasury Department supports the goals of paragraph (a) of the bill, with respect to affiliated groups controlled by foreign persons. We do not oppose the provisions of paragraph (a) of the bill insofar as U.S. controlled corporate groups are concerned.

There are, however, several technical problems in paragraphs (a) through (d) of the proposed section 7518 which should be addressed. We have pointed these problems out in a written submission to the Chairman and would, of course, be pleased to work with the staff in any further drafting that is undertaken.

The second part of H.R. 5076, paragraph (e) of proposed Code section 7518, would restrict state taxation of foreign-source dividends received by corporations. Forty-six states, including the District of Columbia, levy taxes with respect to corporate income; these taxes are either denominated as income taxes or as excise or franchise taxes measured by income. Only a few states have special rules for the taxation of foreign source income, that is, income from sources outside the United States. In most cases, the treatment of foreign source dividend income derives from the general rules for taxing a corporation. Dividends received by corporations from foreign sources are generally excluded from the tax base in about one-third of the states and generally included in the tax base in about two-thirds of the states.

Taxable dividends, whether of domestic or foreign source, usually are apportioned by formula if they are considered business income. Formula apportionment is a method for dividing the tax base among the states, in which the share to be assigned to a particular state is determined by reference to one or more ratios in which economic values or activities within the state are compared with the taxpayer's total activities or values of the same kind everywhere. States differ in how they define business income. Some presumptively consider nearly all income to be business income. Others define business income less broadly by following the definition of business income in the Uniform Division of Income for Tax Purposes Act. It is:

> ...income arising from transactions and activity in the regular course of the taxpayer's trade or business [including]... income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

Under this narrower definition of business income, most dividends would be considered nonbusiness income and would be specifically allocated.

Allocation means the attribution of an income item to a specific geographic category; the particular income is thus attributed wholly to a given state, or is wholly excluded from taxation by a given state. Taxable dividends that are considered nonbusiness income, whether domestic or foreign, are usually specifically allocated to the state of the taxpayer's commercial domicile.

The bill would limit state taxation of dividends received by corporations from foreign corporations by requiring that a specified amount of such dividends be excluded from the state tax base. States would be able to tax only the non-excluded portion. The excluded amount is specified for two classes of corporations: (1) domestic corporations (treated as foreign under the bill) whose dividend distributions are, pursuant to Code section 861(a)(2)(A), foreign source and (2) all foreign corporations. Domestic corporations described in section 861(a)(2)(A) are corporations which either have an election in effect under section 936, or which have less than 20 percent of their gross income from United States sources.

The excluded portion of the dividend received from domestic corporations described in section 861(a)(2)(A) is equal to the deduction allowed by section 243 of the Code or the amount excluded in determining the tax liability of an affiliated group of corporations in accordance with section 1502 of the Code. Section 243 permits a U.S. corporation to deduct 85 percent of dividends received from another U.S. corporation or 100 percent of qualifying dividends received from members of its affiliated group. Similarly, affiliated corporations, in accordance with section 1502, are entitled to a 100 percent dividend deduction. An affiliated group must be connected through at least 80 percent stock ownership. Thus, the bill would exclude from state tax bases either 85 percent or 100 percent of dividends received from corporations with less than 20 percent U.S. source income.

With respect to dividends received from foreign corporations, the excluded portion is equal to the greater of the section 78 "gross-up" or the proportion of the dividend, including the section 78 gross-up, that the foreign tax rate bears to the current 46 percent U.S. corporate tax rate. For purposes of the Federal foreign tax credit, section 78 of the Code requires that the underlying foreign corporate taxes on the earnings out of which foreign dividend income is paid be included in the gross income of the corporation receiving the dividend. In effect, dividends from a foreign corporation are increased by the amount of foreign taxes deemed paid by the recipient of the dividends and for which a foreign tax credit is claimed. By removing this gross-up from the tax base, the bill would prohibit states from including in their tax base amounts expended by foreign subsidiaries for foreign taxes. This exclusion, however, will frequently be less than the alternative exclusion in the bill, the proportion of the total, grossed-up dividend that the foreign tax rate (both underlying corporate tax and dividend withholding tax) bears to the current 46 percent U.S. tax rate. Thus, if total foreign taxes also are 46 percent, the excluded portion of the dividend equals 100 percent, and the entire dividend would be excluded from the state tax base. If, instead, the foreign taxes were one-half the current U.S. rate, or 23 percent, one-half the dividend would be excluded from the state tax base.

The Treasury Department has no objection to requiring that the section 78 "gross-up" be excluded from the state tax base. This would merely require a state to allow an exclusion or deduction for foreign taxes. Although many states already allow this, it seems reasonable to require all states to recognize foreign taxes as a legitimate business deduction.

The treatment of dividends provided by the remaining provisions of the bill might, however, unintentionally favor foreign over United States investment. Many, but not all, states follow the Federal practice of allowing a general deduction for intercorporate dividends from essentially domestic corporations. Consequently, the exclusion for dividends from foreign corporations provided by this bill might be viewed as placing foreign dividends on an equal tax footing with domestic dividends.

But this overlooks the fact that a multistate corporation pays both Federal and state income taxes on its operating income. The dividends received deduction is intended to prevent the taxation of income that already has borne tax at both the Federal and state levels. Neither Federal nor state income tax is paid, however, on the income of a foreign corporation, until that income is repatriated as a dividend to the domestic corporate shareholder. To the extent this bill excludes these dividends from the state tax base, it eliminates the state level of taxation. Accordingly, multinational operations would be taxed more favorably than multistate operations.

The Treasury Department believes that it is undesirable to create a tax preference for foreign investment. While this is

Treasury's primary objection to the second portion of the bill, there are other troublesome aspects. It is unclear why individuals and other taxpayers have been excluded. Similarly, since the bill applies only to dividends, it would favor corporate taxpayers receiving dividends over those receiving rent, interest, and royalty payments. Finally, the bill is geared to the current maximum U.S. corporate rate of 46 percent, rather than the maximum rate in effect at any particular time.

For these reasons, the Treasury opposes the provisions of H.R. 5076 relating to state taxation of foreign-source dividends.

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

FOR IMMEDIATE RELEASE March 31, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,403 million of 13-week bills and for $3,400 million of 26-week bills, both to be issued on April 3, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 3, 1980			26-week bills maturing October 2, 1980		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	96.223 a/	14.942%	15.74%	92.568	14.701%	16.10%
Low	96.188	15.080%	15.90%	92.485	14.865%	16.30%
Average	96.199	15.037%	15.85%	92.516	14.804%	16.22%

a/ Excepting 2 tenders totaling $4,345,000

Tenders at the low price for the 13-week bills were allotted 32%.
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	$ 97,960	$ 88,760	$ 74,030	$ 64,030
New York	5,286,870	2,470,815	5,077,870	2,570,170
Philadelphia	48,575	48,540	38,590	38,590
Cleveland	123,905	73,905	54,765	44,695
Richmond	90,440	89,400	57,070	53,070
Atlanta	101,455	96,445	67,670	67,670
Chicago	479,065	147,005	437,440	215,480
St. Louis	63,015	38,015	52,585	27,585
Minneapolis	14,700	14,700	11,840	11,840
Kansas City	72,520	72,395	47,780	46,760
Dallas	33,785	33,785	20,365	20,365
San Francisco	423,050	157,050	310,585	165,585
Treasury	72,120	72,120	74,160	74,160
TOTALS	$6,907,460	$3,402,935	$6,324,750	$3,400,000
Type				
Competitive	$4,493,350	$ 988,825	$4,360,780	$1,436,030
Noncompetitive	1,323,740	1,323,740	830,870	830,870
Subtotal, Public	$5,817,090	$2,312,565	$5,191,650	$2,266,900
Federal Reserve	870,000	870,000	876,000	876,000
Foreign Official Institutions	220,370	220,370	257,100	257,100
TOTALS	$6,907,460	$3,402,935	$6,324,750	$3,400,000

ield.

DATE: March 31, 1980

	13-WEEK	26-WEEK
TODAY:	15.037%	14.804%
LAST WEEK:	16.532%	15.700%
HIGHEST SINCE:		
LOWEST SINCE:		
2/25/80	13.700%	
3/3/80		14.792%

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

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March 31, 1980

STATEMENT BY
THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE
OF THE
SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

Mr. Chairman:

I appreciate the opportunity to appear before the Subcommittee to support the proposed increase in the United States quota in the International Monetary Fund, to comment on proposed legislation designed to limit U.S. authority to purchase and sell gold, and to support authorization of appropriations for the international affairs functions of the Treasury Department.

Proposed Increase in U.S. Quota in IMF

We meet this morning at a time of severe strain in the world economy. Recent developments, both at home and abroad, have made it necessary for us in the United States to intensify our anti-inflation fight. We do so with total resolve, for I am sure that we all share an awareness that failure to get inflation under control could have ominous implications not only for our economy but for our society as a whole.

The challenges we face in dealing with inflation are not, however, challenges that the United States faces alone. Soaring inflation -- and the concomitant problems of slow growth, low productivity, high interest rates and external payments imbalances -- are worldwide phenomena. During the last two reporting months, wholesale price increases in Japan, Great Britain and and Italy have all exceeded an annual rate of 25 percent. Even in West Germany, a country with a remarkable postwar record of price stability, the inflation rate in wholesale prices is now at double-digit levels.

These somber developments come at a time when there is already considerable tension and strain -- of both a political and economic nature -- in the international community. The tension immediately affecting our political interests is most clearly linked to events in Southwest Asia. The revolution in Iran and the Soviet aggression in Afghanistan have heightened awareness throughout the world of the many different sources of threats to peace and prosperity.

Just as our response to developments in Southwest Asia requires coordination with our allies, so must our response to the rampant inflation and other economic problems that the world now faces be coordinated internationally. As a complement to the domestic measures which the Administration is now taking, we must take steps to strengthen the international monetary system. The most effective instrument that we have to promote a strong, stable international financial structure, the most effective institution that we have to deal with inflation and our other serious economic problems on a worldwide basis, is the International Monetary Fund. The legislation before you today is designed to strengthen that institution and maintain the U.S. role in it.

As the worldwide inflation problem indicates, the global economic outlook as we enter the 1980's is not favorable. The 1970's were already characterized by unprecedented economic problems. Largely as a result of various cooperative efforts, the international community weathered the economic turbulence reasonably well. Nevertheless, adverse oil market developments have again radically affected economic prospects. The re-emergence of a large current account surplus in the OPEC countries and the inevitable generation of a corresponding deficit in the oil-importing world will make serious balance of payments pressures inevitable for a growing number of countries.

At present, we anticipate an OPEC current account surplus of about $120 billion in 1980, and current account deficits, after official transfers, of about $70 and $50 billion for the OECD and LDC groups respectively. A world environment of slower growth, high inflation, heightened caution in the private financial sector, and the continuing threat of energy supply disruptions will simultaneously make the financing of external deficits and the adjustment of national economies to reduce those deficits more difficult. The private financial sector will again meet the bulk of expanding international financing needs -- there is no other source for the magnitudes that will be required -- and flows of official development assistance continue to rise. But we have to anticipate that a number of countries, developed and developing, will encounter growing financial difficulties and pressures to adjust and bring their external positions closer into line with sustainable flows of financing.

Role of the IMF. A strong and effective IMF is critical to our effort to assure world monetary and financial stability, and to provide the broad cooperative framework we will need to overcome fundamental economic difficulties.

The IMF serves two related functions -- general guidance over the operations and evolution of the monetary system, and provision of temporary balance of payments financing.

First, its Articles of Agreement constitute the operating rules of the international monetary system and establish member countries' obligations to promote a cooperative and stable world monetary order. The decade of the seventies brought major changes in the international monetary system and in the IMF's role in guiding the system's operations.

In the area of balance of payments adjustment, the Bretton Woods par value exchange rate obligations have been replaced by obligations on members to pursue policies to achieve the underlying economic stability that is needed for genuine and sustained exchange rate stability. The IMF has been given the task of surveillance over members' compliance with those obligations, and over the operations of the balance of payments adjustment process more generally.

In the area of international liquidity the IMF membership has established the objective of making the Special Drawing Right (SDR) the principal reserve asset in the international monetary system.

These changes are not abstractions. They have paralleled and to a large extent have reflected changes in the position and role of the dollar in the system. The original Bretton Woods arrangements assumed a fixed and central role for the dollar, with the U.S. position essentially passive and the product of other countries' actions in pursuing their own balance of payments policies and objectives. That arrangement ultimately became both unsustainable and intolerable in terms of U.S. economic interests. The new arrangements have provided much more scope for balance of payments adjustment by the United States and recognize the need for greater symmetry in encouraging appropriate adjustments by all nations -- those in surplus as well as those in deficit.

At the same time, the world's reserve system has been undergoing significant change. Increases in the relative economic size and financial capacity of other major countries have tended to lead to some growth in the use of their currencies in international transactions and reserves. On the one hand, such a development can help to mitigate some of the burdens on the dollar and U.S. financial markets that arose from its extremely large international role. On the other hand, the process of change can itself be unsettling and disruptive, and there is a widespread view that increasing reliance on the SDR -- an internationally created and managed reserve instrument -- would be preferable to development of a multiple currency reserve system, with its inherent potential for large and abrupt shifts among alternative currencies. The IMF over the past few years has taken a number of important steps to promote the role of the SDR, and is presently considering a potentially significant further step in its examination of the proposed Substitution Account.

Your invitation to testify, Mr. Chairman, posed several questions regarding the proposed Substitution Account. As you know, the Account would be affiliated with the IMF, and would accept deposits of dollars -- and in time, perhaps other currencies -- by foreign central banks in exchange for claims denominated in Special Drawing Rights. The Account would invest its dollar holdings in interest-earning U.S. government securities and would pay interest to the holders of the SDR-denominated claims.

We believe a properly designed Account could foster greater stability in the monetary system by providing an internationally agreed, non-disruptive mechanism for countries to diversify reserve portfolios and by strengthening the SDR's role in official reserves. Discussions on the Account are progressing, although a number of major issues have not yet been resolved. Key among these issues is the question of assuring financial balance in the Account. A consensus appears to be emerging on use of a portion of the IMF's gold holdings as an equitable, internationally shared means of assurin the Account's financial position.

Some use of IMF gold to help promote the role of the SDR would be supportive of, not inconsistent with, the continued reduction of the monetary role of gold. It would serve to promote the role of the SDR as the world reserve system evolves. It would involve no transactions in gold among monetary authorites, and no addition to countries' gold holdings. And it could, if there were an actual need to use the gold to help balance the Account's financial position, result in further disposal of monetary gold on the private markets.

We have no firm view on the optimal size of the Account. It might well begin with relatively modest amounts and grow over time. Clearly, it should be large enough and attract broad enough participation to be a meaningful step forward in the role of the SDR, but these criteria are difficult to quantify and will require further discussion. Participation in the Account would be voluntary, both because real progress in developing the SDR's role requires genuine commitment on the part of IMF members and because there will be no way to compel countries to participate anyway.

Even with a Substitution Account and other steps to enhance the role of the SDR, the dollar remains critically important to the operation of the international monetary system, and the U.S. economy remains a powerful element of that system. This will continue to be the case, and we recognize and accept the responsibilities incumbent on the United States to maintain a sound economic position and stable dollar. The recent comprehensive measures announced by the President to combat inflation reflect our firm commitment to these objectives.

The second basic function of the IMF, closely tied to its role in guiding the overall operation of the system, is the provision of temporary financing in support of members' efforts to deal with their balance of payments difficulties. Its aim is to encourage timely correction of balance of payments problems in a manner that is not destructive of national or international prosperity -- and thus to promote a smoothly functioning world payments system in the context of a strong and stable international economy. This is a central objective of the IMF, and one in which all must participate as an obligation of IMF membership.

The IMF is essentially a revolving fund of currencies, provided by every member and available to every member for temporary balance of payments financing under prescribed criteria. Each country is obligated to provide its currency to the IMF to finance drawings by other countries facing balance of payments needs; and each country in turn has a right to draw upon the IMF in case of balance of payments need. When a country provides financing to the IMF -- that is, when its currency is drawn from the Fund -- it receives an automatic and unchallengeable right to draw that amount from the IMF in usable foreign exchange. This is the so-called "reserve position" in the IMF, an automatically available reserve claim on the IMF which is normally carried in countries' international monetary reserves.

Financing thus flows back and forth through the IMF depending on balance of payments patterns and financing requirements at any given time. There is no fixed class or group of lenders or borrowers, no concept of "donor" or "recipient" in the IMF. It is not an aid institution. All major industrial countries have drawn upon the IMF at times. Many members, developed and developing alike, have been on both sides of the financing and drawing ledger during the history of their participation. In fact, while the U.S. quota subscription has been drawn upon many times over the years, our own drawings on the IMF, totaling some $7.5 billion, are the second largest of the entire membership.

Proposed Increase in Quotas. Quotas are central in the IMF. Members' quota subscriptions constitute the IMF's permanent financial resources. Quotas determine both the amount of IMF resources a member can draw when in balance of payments need, and its obligation to provide resources when its balance of payments is strong. Quotas determine the distribution of SDR allocations. And, of key importance in all IMF operations, quotas also determine voting power. Unlike the case in many institutions, where member countries try to hold down their shares of participation, countries compete to gain the largest possible share of the total in the IMF because of the financing and votes that a larger quota share provides.

To ensure that IMF quotas remain realistic and adequate, they are reviewed periodically in relation to the growth of international transactions, the size of payments imbalances and financing needs, and world economic prospects. Such a review was initiated in 1977, and led to a resolution adopted by the IMF Board of Governors on December 11, 1978, with the U.S. Governor concurring, calling for an increase in overall IMF quotas by 50 percent, raising total quotas from about SDR 39 billion to roughly SDR 58 billion. The increase proposed for the U.S. quota amounts to SDR 4,202.5 million, equivalent to about $5.3 billion at current exchange rates. This increase would raise the U.S. quota by 50 percent, from SDR 8,405 million (or about $10.6 billion) to SDR 12,607.5 million (or about $15.9 billion).

The negotiation of quota shares is always difficult, with pressures on the U.S. to accept a smaller quota share. Given the key roles of the dollar and the U.S. economy in the international monetary system, and the IMF's central role in guiding the operations and evolution of the system, it is essential that the U.S. maintain an appropriate share of quotas and votes, and thus its influence over basic decisions about the system. In the end, the pressures for a reduced U.S. share were successfully resisted during the most recent review, and only a very few selective changes in quota shares were agreed.

The decision to propose a 50 percent overall increase in quotas reflected a widely felt view that quotas had, by any measure, failed to keep pace with potential balance of payments financing needs. Despite quota increases on four occasions during the IMF's history, aggregate quotas had fallen to about four percent of annual world imports, in comparison with 8 to 12 percent during the 1960s and 10 to 14 percent during the 1950s, as illustrated in the attached chart. The adequacy of quotas had eroded particularly during the seventies, as the ratio of quotas to members' aggregate current account deficits fell by two-thirds between 1971-73 and 1978. In mid-1978 the Fund's usable quota resources -- that is, its holdings of the currencies of members then in strong payments positions -- totaled only about SDR 16 billion, or just over one percent of world imports. In November 1978, before the Supplementary Financing Facility was put in place, the amount of usable quota resources was effectively halved to around SDR 8 billion, when the U.S. drew the equivalent of $3 billion and the dollar was taken off the IMF's "budget" of currencies used in financing current drawings.

These shifts in the IMF's "liquidity" illustrate the difficulties of projecting either the level of usable IMF resources or the level of future drawings on the Fund. In its 1977 quota review, the IMF estimated that the level of international transactions between 1978 and 1983 would increase by 60 percent in SDR terms. In fact, that 60 percent figure is now much too low as inflation, oil price increases and other factors have caused a much more rapid expansion in the value of world trade and financial transactions. And, even if we could accurately predict future levels of world trade, we would not know the pattern of trade, the size and distribution of payments imbalances, or the availability of financing from banks and other sources.

In determining how a large quota increase would be needed, it was recognized that the IMF's Supplementary Financing Facility would be phased out after a 2-3 year period. That Facility, for which U.S.

participation was approved by Congress late in 1978, has proved to be an extremely important temporary reinforcement of IMF resources during a period of growing financial strain. The Facility began operation in early 1979 on the basis of financial commitments amounting to about SDR 7.8 billion. OPEC countries are providing over 40 percent of the total with Saudi Arabia the largest single participant. To date, the Facility has been used in conjunction with IMF programs totaling about $3 billion and is assisting a wide variety of countries of special interest to the U.S. -- including Turkey, Peru, Korea, the Philippines and Sudan -- in dealing with severe payments difficulties. A number of countries are now discussing with the IMF programs under the Facility, and total use before the Facility expires (scheduled for early 1981 or 1982) should be substantial. This Facility, designed as a temporary bridge to the quota increase now in process, is a timely and valuable source of support for the Fund's operations in this period, and Congressional approval for it has proven to be extremely wise.

It was in the light of these considerations that the IMF membership concluded that a 50 percent increase in total quotas would be the minimum required to assure that the IMF remained in a strong position to meet prospective needs. Even a 50 percent increase will do little more than temporarily halt the decline in the relative size of IMF resources into the mid-1980's. In fact, most developing countries and some OECD members, fearing growing world economic uncertainties, pressed hard for a much larger increase.

Events since completion of the quota review have strengthened the need for the quota increase. Oil market developments have again substantially altered economic prospects and drawn the world into a pattern of sizeable payments imbalances. Countries must, and will begin adjusting to these developments, and that will cause further changes in world balance of payments patterns and financing needs that cannot now be foreseen. Moreover, events in Iran and Afghanistan have created a climate of concern and uncertainty that makes it all the more important to have in place the institutional means for assuring monetary stability and providing advice and financial support to countries facing the growing economic and financial problems of the 1980s.

The IMF must have adequate resources -- and this means adequate quotas -- to encourage countries to adjust in an appropriate way, rather than adopt trade and capital restrictions, aggressive exchange rate policies, or unduly restrictive domestic measures in order to reduce their financing needs. Such restrictive measures could have serious implications for the entire world economy and the prosperity of all nations, as well as for the economy of the country introducing them. We must not forget the lessons of the 1930's, when serious economic troubles were worsened by ultimately self-defeating actions of nations trying individually to preserve employment and prosperity during times of economic distress and international tension.

The impact on the United States today could be especially harmful. Our economy has grown heavily reliant on world trade and financial flows. An interdependent world brings real economic benefits, but also greater vulnerability to outside developments. Imported goods, from raw materials to high technology products, are integrated into all phases of U.S. economic activity. Export markets constitute a major source of demand for U.S. goods and services. One out of every 7 U.S. manufacturing jobs, and one out of every 3 acres of U.S. agricultural land produce for export. One out of every three dollars of U.S. corporate profits comes from foreign operations (exports and investments). For the U.S. economy specifically and the world economy generally, prosperity is dependent on a well-functioning international financial system.

Uncertainties about the magnitude, distribution and financing of payments imbalances over the next few years make it impossible to project the precise amount of IMF resources that will be used during the next five years. But we must assure ourselves that the IMF's resources are sufficient to enable it to meet its important responsibilities -- sufficient as measured against historic standards and current trends, and sufficient against a realistic appreciation of the dangers we face as we enter a new decade.

<u>IMF Conditionality</u>. A specific issued raised in the Chairman's letter was whether IMF conditionality policies should be changed so as to prevent any conflict with the fulfillment of the basic human needs of countries drawing on the Fund. By way of background, let me first make some general statements about IMF conditionality. It is one of the most important and least understood aspects of IMF assistance to its member countries. Conditionality is not designed to change the basic character of a member's economy, nor interfere in its socio-political evolution, nor punish the country for economic mismanagement. The central purpose of conditionality is to provide the IMF a pragmatic means through which to encourage the adoption of policies which will in fact correct the economic difficulties that resulted in balance of payments problems and the need for Fund financing in the first place.

It is important to remember that, whatever the cause of a country's balance of payments problem, unless it is temporary and self-reversing, the country will ultimately have to adjust -- it cannot indefinitely spend reserves and borrow abroad. Without policy adjustments, the country's creditworthiness and ability to borrow abroad will inevitably decline, trade credit will evaporate, investment will generally fall, and growth will decline or become negative. This in itself is one form of adjustment, but it is a harsh and inefficient adjustment. What may look like the easy way out is in fact very costly, and can make the return to sound economic growth an extremely difficult and slow process.

Most governments will make policy adjustments before the situation deteriorates to that extreme, but sometimes a country will not approach the Fund until the situation is desperate. This is a key point to remember. The Fund does not cause the lack of foreign exchange that interrupts vitally needed imports. Indeed the IMF, often alone, tries to help by providing resources to maintain the economy and balance of payments temporarily, and by providing policy advice to restore economic stability and sustained growth.

However, in return for this financing, the world community expects the government to foreswear measures disruptive to the world economy. To assure repayment, and the most beneficial results for the country, the Fund requires that the member undertake appropriate measures to solve its balance of payments problems. The adjustments that have to be made often involve short-term retrenchment -- with or without the IMF. With the IMF, a short-term period of belt-tightening is more likely to be orderly and effective. If a country has gotten into very serious problems, and is spending far beyond what it can produce or finance on a sustainable basis, there will have to be cutbacks. These may well affect virtually all segments of the population. This is painful. But there is also pain and harm -- perhaps much greater harm to the poorest -- in letting a pervasive and destructive inflation and/or an external imbalance go unchecked, reducing real national incomes; permanently distorting consumption and investment patterns and eroding the basic productive capability of the economy. If a Fund program can help establish a functioning base for growth and development, then the longer term benefits, social and economic, can far outweigh any shorter term costs.

Requests for IMF financing are initiated by the member country, and the precise type of financing and its terms are settled through discussions between the member government's representatives and the IMF. Each member proposes its own stabilization program in support of its financing request. The Fund does not insist on a particular method of adjustment and recognizes that economic structure and circumstances differ among members.

The reasons why the Fund takes this approach are practical and philosophical. It is appropriate for the IMF to say how much adjustment a country should undertake as a condition for obtaining financing, and establish overall targets for monetary growth, the budget deficit and other macroeconomic variables. But the IMF should not tell a country whether it must cut military expenditures or social programs, or that it must tax this and subsidize that, or cut employment here and expand it there. These detailed implementing decisions must be made by the government concerned. It is highly unlikely that the United States would ever accept such interference with U.S. sovereignty. Neither will other countries.

There are various policy combinations which would permit a country to meet the targets negotiated with the IMF, so the member presumably chooses one that most conforms to its particular circumstances and objectives. Of course the IMF may well have views of what are efficient and equitable policy mixes, and can discuss these with a prospective borrower if appropriate. There are cases where the Fund staff has advised against certain actions because of their likely social costs. The U.S. has, on a number of occasions, urged the Fund to suggest programs to governments that are conducive to development and social goals, while meeting overall economic requirements. But in the end the individual government is responsible for its own stabilization program -- both in design and implementation -- even though the IMF is often made the scapegoat for unpopular choices

However, within these very real constraints, the IMF is making a continuing effort to improve and better adapt itself to the needs of its members. First, reflecting the generally increased scale and persistence of balance of payments problems, the IMF now provides more financing for longer periods for nations with adjustment problems. Quota limits on drawings have been expanded and, for drawings with higher conditionality in the upper credit tranches, two and three year programs have become much more the accepted rule, in contrast to the one-year program that was traditional in earlier days.

In addition, a variety of IMF facilities are now available to members, ranging from unconditional reserve tranche drawings through facilities such as the Compensatory Financing Facility and the first credit tranche (both with relatively "light" conditionality requirements) to the upper credit tranche and Extended Fund Facility drawings. Of total drawings amounting to nearly $30 billion since 1973, roughly two-thirds has been drawn from unconditional or relatively unconditional facilities. Some countries have, of course, gotten into more serious difficulty and have had to turn to the more conditional facilities -- which have themselves been expanded and adapted -- and these are the cases one hears about most often. But it is important to bear in mind the whole spectrum of IMF financing facilities when assessing its role in balance of payments financing and adjustment.

Second, the IMF in 1979 undertook a major review of conditionality and established a new set of guidelines. To an extent the new guidelines formalize certain protections for borrowing countries that had already existed in practice, but they also add important new features. For example, they now emphasize the desirability of encouraging countries to adopt corrective measures at an early stage -- before very severe adjustment policies may be needed -- and recognize the need for more gradual and more flexible adjustment over longer periods. They also recognize that adjustment measures frequently encompass sensitive areas of national policy, and provide that in helping to devise adjustment programs the Fund will pay due regard to the domestic social and political objectives, the economic priorities and the circumstances of members, including the causes of their balance of payments problems. They provide that "performance criteria" will normally be confined to macro-economic variables (other than those performance criteria needed to implement specific provisions of the Articles, such as the avoidance of exchange restrictions). The new guidelines should help dispel the idea of conditionality as a weapon for imposing unnecessary hardships -- and make clear that for countries with severe imbalances, adequate and timely adjustment, which is the objective of IMF conditionality, is in the best interests of both the individual country involved and the world community.

The third change in the IMF's approach to adjustment, and a particularly important one, is one that I stressed earlier -- its new role in surveillance. Surveillance over every IMF member's efforts to foster orderly underlying economic and financial conditions provides valuable IMF leverage for promoting sound adjustment policies by all countries, surplus or deficit, whether or not they draw on the IMF's resources. It is designed to introduce a badly needed symmetry to the international monetary system, more effectively encouraging adjustment efforts by surplus countries, and not leaving the entire burden of adjustment on deficit countries. Development of IMF surveillance can be helpful in various ways. To the extent it encourages <u>earlier</u> adjustment action, it helps to avoid the more severe corrective measures which become necessary as a country's situation worsens; and to the extent it encourages adjustment action by <u>all</u> countries with large imbalances, it reduces the relative emphasis on those deficit countries drawing upon the IMF.

Thus the IMF is making a continuing effort to adapt to the changing needs and circumstances of its members. This process should, and will, continue. But as we move to adapt IMF policies and practices, we need to keep the IMF's basic purposes clearly in view, and ensure that its programs do, in fact, effectively promote adjustment by its members. This is in the individual borrower's own interests and of the international community as well.

<u>IMF and the Budget</u>. Before concluding this discussion of the IMF, let me mention the question of the budget and appropriations treatment of this quota increase. The President's budget submitted in January proposed that a program ceiling on the increase be provided in an appropriations act. We have been consulting extensively on this question with interested committees, and it appears that considerable interest is developing in an alternative approach which would involve the following:

-- Appropriations would be required in the full amount of the increase, and that sum would be included in budget authority totals for fiscal year 1981.

-- Payment of the quota increase would result in budgetary outlays as cash transfers are actually made to the IMF on the U.S. quota obligation.

-- Simultaneously with any cash transfer, an offsetting budgetary receipt, representing an increase in the U.S. reserve position in the IMF, would be recorded.

-- As a consequence of these offsetting transactions, transfers to and from the IMF under the quota obligations, therefore, would not result in net outlays or receipts.

-- Net outlays or receipts resulting from exchange rate fluctuations in the dollar value of the SDR-denominated U.S. reserve position in the Fund would be reflected in the Federal budget. These net changes cannot be projected and thus would be recorded only in actual budget results for the prior year.

We are continuing our consultations on this matter. The point I would stress today is that under either the program ceiling in the President's budget or this alternative approach, U.S. payments on its quota subscription would not affect net budget outlays or the Federal deficit.

Conclusion on IMF. In concluding my remarks on the IMF, I would like to reemphasize my strong conviction that the IMF is essential to U.S. interests. The proposed quota increase is important for a number of reasons.

From the point of view of the international monetary system as a whole, it will help assure that the IMF can continue to meet its responsibilities for international monetary stability in a period of strain, danger and financial uncertainty. From the point of view of individual countries, it will provide additional resources to encourage constructive balance of payments adjustment policies -- and I note that IMF resources have been of major direct benefit to the United States when we faced severe balance of payments pressures. From the point of view of the United States, it maintains our financial rights and our voting share in the institution during a time when far-reaching changes in the monetary system -- for example, a substitution account -- are under consideration.

The record of the IMF is a good one, in adapting to changing world circumstances and responding to the needs of its members. The proposed quota increase will provide the Fund with resources needed for its valuable work, and I urge the Committee to approve this legislation.

Proposed Legislation to Limit U.S. Authority to Purchase and Sell Gold

Mr. Chairman, you have requested my views on S. 1963, a bill that would require prior Congressional authorization for any purchase or sale of gold by the Treasury unless the purpose of the transaction is to maintain a permanent relationship between the dollar and gold. We strongly oppose this bill.

The U.S. has long supported continued reduction in the international monetary role of gold. Its key monetary functions have in fact been eliminated. The official price of gold in the IMF has been abolished as have related obligations for countries to buy or sell gold. Establishment of IMF par value obligations in terms of gold has been prohibited. The use of gold as a common denominator for IMF transactions has been eliminated.

There are no requirements for use of gold in official settlements, and there have been no significant transactions in gold between monetary authorities since U.S. suspension of gold convertibility in August 1971.

Nonetheless, gold remains a substantial part of world monetary reserves, and that is likely to remain the case for many years. Gold represents a large part of U.S. reserves, available for use in times of balance of payments need. The Secretary's authority to sell gold has been extremely valuable in strengthening our balanc of payments position and contending with the exchange market difficulties that have arisen over the past few years. U.S. sales of gold have, since initiation of the current program in May 1978, strengther the U.S. trade and current account positions by an estimated $4.1 billion, and have thus been a significant factor contributing to dollar strength and stability. Moreover, the Secretary's flexibility to determine the timing and amounts of sales is of great value in dealing with instances of exchange market disturbances that are attributable in part to speculative activity in the gold markets. The exercise of the Secretary's authority has been prudent and in the national interest. To limit it, as proposed in S. 1963, would remove an extremely important element of the United States' ability to manage its external monetary position.

Moreover, Mr. Chairman, the bill appears to envisage, or at least welcome, efforts to reestablish a fixed price for gold. We have no intention of making such an effort, and I believe it would be very unwise for the Congress to indicate its receptivity to such an effort. Limited supplies of gold, with new production subject to natural constraints and concentrated in two countries -- South Africa and the Soviet Union -- and the growth of industrial and commercial uses, result in a supply of gold available for monetary purposes that is wholly unrelated to the needs of an expanding world economy. The price of gold is highly volatile, and swings in price are huge -- recently as much as $100 per ounce in the space of only a few hours. Any attempt to fix the price of gold in terms of currenc and tie the supply of money to gold stocks would lead to swings in employment, output, and general price levels which no country would tolerate. No major country today allows the value or supply of its currency to be determined by gold. In the United States, the monetary role of gold has been reduced through a series of actio and legislation spanning 40 years and enjoying wide bipartisan suppo That trend is sound and should be reaffirmed through Congressional rejection of this bill.

International Affairs Budget Request

Mr. Chairman, I would now like to turn to a third issue mentioned on your invitation, the administrative costs of the Treasury's international affairs functions.

The foregoing discussion highlights the scope, complexity, and importance of the Treasury's international responsibilities, and activities.

The Treasury Department, through its international affairs functions, plays a key role in assuring that U.S. international economic policies support the needs of our domestic economy and enhance the economic benefits of our global interdependence. The Secretary of the Treasury has major international responsibilities: he is Governor for the United States in the International Monetary Fund, the World Bank and other multilateral develoment banks; Co-Chairman of the Saudi Arabian-United States Joint Commission on Economic Cooperation; co-Chairman of the U.S.-U.S.S.R. Commercial Commission; and co-chairman of the U.S.-China Joint Economic Commission. The Secretary oversees U.S. international monetary policy and operations, represents the United States in discussions and negotiations of bilateral and international monetary and financial issues with other nations, and closely assists the President at economic summit meetings. Treasury's views provide important input in the interagency determination of U.S. policies on international trade, development, energy and commodities issues.

Our fight against inflation, in particular, must include international as well as domestic policy initiatives. A stable dollar, a fair and open system of international trade and investment, and efforts to stabilize international food and commodity prices are essential aspects of our efforts to avoid additional inflationary pressures. Smoothly-functioning international monetary arrangements are important to the preservation of an open and efficient system of international trade and investment, which are vital to our economic interests, and to the maintenance of a strong and competitive U.S. economy.

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

The authorization of appropriations that we are requesting for fiscal year 1981 for the international affairs function is approximately $25.4 million -- comprised of $24.3 million for the basic expenses and $1.1 million which would be available only for the payment of authorized cost of living increases in pay and overseas allowances and benefits. Due to the technical requirements of the Congressional Budget Act of 1974, we have also requested authorization of such sums as may be necessary for fiscal year 1982.

Secretary Miller and I are deeply concerned that the international affairs functions of the Treasury Department be carried out in as efficient a manner as possible. While our overall international responsibilities have grown more complex and demanding, we have been able to meet our requirements through more efficient use of existing resources and a minimum of expanded budget authority. In 1976, for example, there were 555 permanent positions. The request before you today is for 460 permanent positions. The basic increase in funds requested for 1981 is slightly more than 5 percent above the authorized level for the current fiscal year.

The nature of the Treasury's international work requires significant foreign travel. This is unavoidable, but we have made major and continuing efforts to reduce travel expenses. Travel expenses in 1975 were $1,326,000. In 1979 we spent $1,033,000 on foreign travel. In 1981 we are requesting $1,057,000 or an increase of approximately 2 percent over last year's actual expenses. Inflation and dollar depreciation notwithstanding, we have managed to reduce travel expenses by 20 percent in the last five years. Other changes in the budget include an increase of $1,308,000 to maintain current levels of operations. These increased requirements are partially offset by expenditure reductions totaling $824,000, including reductions of $634,000 due to productivity increases.

The one new significant item in our proposed authorization is a program increase of $700,000 to permit us to equalize the salaries of U.S. nationals employed by the Asian Development Bank (ADB) with other nationals employed by the Bank.

The ADB has a well-deserved reputation for prudent policy, effective management and low administrative costs. In part, the Bank's ability to keep administrative costs low resulted from the relatively low cost of living in Manila. However in recent years there has been a dramatic change in this situation, putting severe pressure on U.S. nationals employed at the Bank, and leading to a sharp erosion in U.S. representation on the Bank's staff. The cost of living has increased by 70 percent in Manila over the last three years, compared to a 32 percent increase in Washington. Housing costs in particular have soared and are now a major deterrent to accepting employment with the ADB. For example, in today's housing market in Manila, the United States Government spends over $25,000 per year to provide a married GS-16 employee, with two or more dependents, with appropriate accommodations. Housing costs are therefore about twice those of equivalent accommodations in the Washington, D.C. area, and are increasing at a faster rate.

ADB staff salaries are established on the assumption that they will be exempt from national income taxes. U.S. citizens are the only expatriates on the staff of the Bank whose salaries are subject to taxes. The 1978 revision of U.S. tax laws regarding foreign earned income has placed these Americans at a severe disadvantage; they now receive, on the average, 20 percent less than other nationals at the ADB. The difference in disposable incomes after taxes and housing expenses, compared with U.S. Government officials in Manila at the same basic rate of pay, are even greater.

These problems have made employment with the ADB a serious hardship for the U.S. nationals already there, and has made recruitment of qualified U.S. citizens almost impossible.

During 1979, eleven Americans out of 31 resigned from the ADB, and other resignations are expected in the near future. There are now only five Americans, out of a total of 54, at a level equivalent to GS-16 or above in the Bank, compared to seven from Japan, and 15 from South Asia. Other member countries exert maximum efforts to place their nationals at these levels in all international organizations. If the U.S. presence were to erode permanently, the philosophical make-up of the ADB staff could change. Continued employment of U.S. citizens on the staff of the ADB is of considerable policy importance to the United States, as it helps contribute to more effective implementation of ADB policy and projects.

The United States currently has cumulative subscriptions in the Bank of over $1.3 billion, and these contributions to the Bank are growing by several hundred million dollars each year. Congress has long urged employment of U.S. nationals on the staffs of international organizations, and provides similar salary adjustments for U.S. citizens employed at all U.N. agencies through appropriation to the Department of State.

I should also mention one other technical provision of the proposed authorization bill. The first section of the bill corrects an oversight in Treasury's existing legislation to further assure that we can pay, for our overseas employees performing international affairs functions, allowances and benefits comparable to those provided to employees of the Department of State. Currently, Treasury is authorized to pay allowances and benefits comparable to those provided to State Department employees by title IX of the Foreign Service Act of 1946. However, additional allowances for educational travel for dependents of State Department employees are authorized by another statutory provision (5 U.S.C. 5924 (4) (B)). Under this provision, State Department employees receive travel allowances for two round trips for each dependent each year for undergraduate education and one round trip for each dependent each year for secondary education in the United States. Treasury Department employees, however, receive travel allowances for only one round trip for secondary school and one round trip for undergraduate education in the United States for each dependent during the employee's <u>entire</u> overseas tour of duty. The proposed amendment would correct this present inequity and align Treasury travel allowances for such dependents with those of the State Department.

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In conclusion, Mr. Chairman, I urge the Committee to act promptly and favorably on the proposed legislation to increase the U.S. quota in the IMF and to authorize appropriations for Treasury's international affairs functions.

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FOR RELEASE ON DELIVERY
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STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY
FOR DOMESTIC FINANCE
BEFORE THE STATE, JUSTICE, COMMERCE, THE JUDICIARY AND
RELATED AGENCIES SUBCOMMITTEE
OF THE SENATE APPROPRIATIONS COMMITTEE

Mr. Chairman and Members of the Committee:

My testimony will discuss the Administration's request for two appropriations relating to the Chrysler Loan Guarantee Program: first, a full one-time appropriation enabling the Chrysler Corporation Loan Guarantee Board to make payments of principal and interest on any guaranteed loan in default; and, second, an appropriation to cover the Fiscal Year 1981 administrative expenses of implementing the Guarantee Act.

A One-Time Full Appropriation

Mr. Chairman, the Administration requests a one-time appropriation through December 31, 1991, of such sums as are necessary to make payments of principal and interest, if there is a default, on the $1.5 billion principal amount of loans which are authorized to be guaranteed. As you know, all guaranteed loans must mature

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by December 31, 1990. However, the appropriated sums should remain available until December 31, 1991, to provide extra time for resolution of any dispute or litigation over a payment due in 1990.

Mr. Chairman, when I appeared before this Committee last December, the Administration sought an appropriation with two elements:

- A one-time authorization permitting the Guarantee Board to issue guarantees of the principal and interest on the loans for the benefit of Chrysler for the full $1.5 billion principal amount authorized by the Guarantee Act, plus such additional amounts as may be necessary to pay interest which may be in default; and
- A one-time appropriation of such sums as are necessary to make payments of principal and interest, if there is a default, on all of the loans which could be guaranteed.

The Congress provided the first element, but not the second. The Appropriation Act (PL 96-183) passed by Congress on January 2, 1980, authorized the issuance of guarantees, but only committed to make the necessary appropriations to make payment under the guarantees.

Cost and Marketing Factors

In December, I testified that providing the latter appropriations would be necessary to assure that the financing plan could be assembled. Chrysler's financial advisors, Salomon

Brothers and its special counsel, Debevoise, Plimpton, Lyons & Gates have further investigated the marketing issues and confirmed the concerns that I voiced in December: without the appropriation, both the unguaranteed and guaranteed financing will be troublesome or significantly more costly to Chrysler.

Guaranteed Assistance

A guarantee which is not backed by a one-time full appropriation may result in unnecessary added financing costs for Chrysler. Specifically, lenders will seek an additional interest premium on guaranteed loans, since payment on a default could be delayed due to the need for congressional action to appropriate sums for payment. Such increased interest charges would increase the financial liability of the Federal Government on its guarantees. Furthermore, to the extent that a guarantee fee is negotiated which involves a share of profits, the increased interest cost will reduce the fees to the Federal Government.

Chrysler's financial advisors believe that this interest premium attributable to the lack of appropriation could approximate two full percentage points (200 basis points) over a comparable three-year issue of Treasury securities. A copy of their letter is appended to this testimony, together with Chrysler's. This means that Chrysler could incur $90 million of additional interest expense over three years on the full $1.5 billion of guarantees.

Treasury generally agrees that Chrysler would incur much higher interest costs, although we have made no specific estimate. Chrysler's advisors also indicate that the guaranteed loans may be difficult to sell without the appropriation under the market conditions that it projects for this summer. Indeed, initially Salomon Brothers hoped to sell guaranteed securities with maturities approximating 6 months. Because of the lack of appropriations to pay the guaranteed securities, they are now recommending maturities of one to two years.

Furthermore, it also would be difficult to obtain the necessary long-term unguaranteedd financing commitments unless clear-cut Federal guarantees were available. This was our experience in other guarantee programs of this nature, such as New York City. To the extent questions are raised concerning the ability to sell guaranteed securities, the success of these negotiations may be impaired.

The Need for a Full $1.5 Billion Appropriation

Mr. Chairman, I request that the Congress appropriate sums to make payment on the full $1.5 billion of principal and relevant amounts of intrest, to be made available beginning immediately through 1991, because Chrysler may ultimately draw down the full amount of authorized guarantees. The company's latest projections indicate less than full usage, but those projections are being revised substantially.

Timing

Mr. Chairman, an Appropriation Act is necessary immediately to help assure that the Congressional aims of the Guarantee Act are satisfied.

Specifically, Chrysler's cash flow outlook indicates that overall guaranteed and unguaranteed financing plan must be implemented within the short-term. Also, most guaranteed loans will be needed during this fiscal year and the early part of 1981, although no payments will be made under the guarantees during this fiscal year because the guaranteed loans are not expected to mature until later.

Mr. Chairman, Chrysler and those with an economic stake in its future have made progress in meeting the requirements of the Guarantee Act. Chyrsler has revised its operating plan and has developed a related financing plan. Significant progress has been made toward assembling the long-term unguaranteed financing which is a condition required for Federal guarantees:

- Chrysler and its unions have entered into a revised labor contract to provide $462.5 million in required wage concessions. Chrysler also has adopted a plan to obtain $125 million in wage concessions from its non-union employees.

- State and local governments have been moving forward with legislation and other programs to provide the $250 million of financing which the statute requires of them.

- Chrysler is now soliciting its dealers and suppliers to purchase at least $230 million in subordinated debentures. Commitments are expected in early April.

- Chrysler is in negotiations with its domestic and foreign lenders to provide the $650 million in contributions and concessions required from them in adition to extensions of amounts commited as of October 17, 1979.

° Chrysler has identified assets to be sold to meet the $300 million target for proceeds from asset dispositions and has entered into related negotations.

Furthermore, Chrysler is negotiating with the Canadian Government and others for financing that might bring the total package to more than the $1.43 billion.

Mr. Chairman, it would be indeed unfortunate if after all this effort and progress, this rescue effort were to fail or be significantly frustrated by a relatively technical issue such as this appropriation question.

Administrative Expenses

Mr. Chairman, the Administration also requests a supplemental appropriation for Fiscal Year 1981 of approximately $1.3 million, including funding for 20 permanent positions to enable the Board to administer the loan guarantee program established by the Guarantee Act. As you know, our approach to this program is to seek appropriations for administrative expenses only on an annual basis.

These funds and positions are necessary to maintain the Office of Chrysler Finance and related support activities in the Treasury Department. The Loan Guarantee Board requires staff assistance and other services to satisfy its responsibilities under the Act. Those responsibilities include negotiations over the guaranteed and unguaranteed portions of Chrysler's four-year financing plan; the continuing analysis of Chrysler's four-year operating plan, its financing plan, and other plans necessary for the Board to make the determinations required by the Act in order to issue guarantees; and preparation of annual reports to Congress concerning its activities. These responsibilities will continue throughout the entire period that guarantee commitments and guaranteed loans are outstanding. The expertise necessary will continue to require contractual services from experts in the private sector. Specifically, we have employed the public accounting and management consulting firm of Ernst & Whinney to help us analyze and evaluate Chrysler's current status and its operating and financial plans. We have also hired the law firm of Cahill Gordon & Rheindel to help us prepare the legal documents and review legal issues incident to the financing transaction, including security arrangements.

Our appropriation for these administrative purposes for Fiscal Year 1980 was approximately $1.5 million and 20 permanent positions. To date, we have filled approximately one-half of these positions. In the meantime, we have relied significantly on outside experts, with approximatley $1 million of the $1.5 million budgeted for their fees. Our reliance on outside experts should diminish after we make our initial determinations and complete any financing agreements.

That diminution, however, will produce additional staff responsibilities. Thus, for 1981, approximately $600 thousand is budgeted for consultants, and $500 thousand for internal staffing with the remainder for incidental expenditures.

Of the internal positions, 14 are professionals: 11 financial analysts, and three attorneys. Of the analysts, one slot is held by the Office Director, and the remaining ten are divided equally among individuals responsible for Chrysler's operating plan and among those responsible for its financing plans and ongoing finances. The remaining slots are for clerical personnel.

I would be pleased to answer any questions.

oOo

Members of the New York Stock Exchange, Inc
One New York Plaza
New York, N.Y. 10004 (212) 747-7000

Salomon Brothers

February 15, 1980

Chrysler Corporation
Loan Guarantee Board
Room 3000
15th and Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Gentlemen:

On behalf of Chrysler Corporation, for whom we are acting as financial advisor, we hereby recommend that the Chrysler Corporation Loan Guarantee Board (the "Board") take the necessary steps to obtain the specific appropriation of such funds as may be required for the payment of principal and interest on up to $1,500,000,000 aggregate principal amount of loans guaranteed under the Chrysler Corporation Loan Guarantee Act of 1979 (the "Act"). Such funds should remain available at least until some reasonable period after December 31, 1990, the final authorized date for maturity of a guaranteed loan.

It is our judgment that the absence of specific appropriation of such funds would have an extremely adverse impact on the marketing of debt to be guaranteed by the Board, and also with respect to the pricing of such debt.

Accordingly, we strongly recommend that the specific appropriation be made prior to any issuance of debt to be guaranteed by the Board.

Very truly yours,

Salomon Brothers

SALOMON BROTHERS

CHRYSLER CORPORATION

March 3, 1980

Chrysler Corporation Loan
Guarantee Board
c/o Treasury Department
15th and Pennsylvania Avenue, N.W.
Washington, D.C. 20020

Attention: Mr. Brian M. Freeman
Executive Director
and Secretary

Specific Appropriation under
Chrysler Corporation Loan
<u>Guarantee Act of 1979</u>

Dear Sirs:

By letter dated February 15, 1980, Salamon Brothers, our financial advisor, recommended that the Chrysler Corporation Loan Guarantee Board take the necessary steps now to obtain the specific appropriation of such funds as may be required for the payment of principal and interest on up to $1,500,000,000 aggregate principal amount of loans guaranteed under the Chrysler Corporation Loan Guarantee Act of 1979.

At a meeting held today at the office of the General Counsel of the Department of the Treasury further discussions concerning the necessity for specific appropriation of funds were held. In addition to the General Counsel and one of his staff, representatives of Salomon Brothers, Debevoise, Plimpton, Lyons & Gates, Patton Boggs & Blow and Brown, Wood, Ivey, Mitchell & Petty participated in the discussions.

Based on today's discussion, and on advice from its legal and financial consultants, Chrysler hereby requests the Board to proceed as swiftly as possible to obtain specific appropriation of funds. The supplemental appropriation language pending before Congress (a copy of which is attached hereto) is satisfactory to us.

Please let us know if any further information is required or if Chrysler or any of its advisors can be of further help in the legislative process by which the specific appropriation we have requested will be obtained.

Sincerely yours,

Robert S. Miller Jr

Robert S. Miller, Jr.
Assistant Controller

Department of the Treasury

BUREAU OF GOVERNMENT FINANCIAL OPERATIONS

CHRYSLER CORPORATION LOAN GUARANTEE PROGRAM

(Supplemental appropriation language request pending)

There are appropriated such sums as may be necessary for payment of principal and interest on loans guaranteed pursuant to the Chrysler Corporation Loan Guarantee Act of 1979 and in default, to be available immediately and to remain available until December 31, 1991.

This supplemental appropriation language is pending before the Congress. This language is needed for the implementation and administration of the Chrysler Corporation loan guarantee program.

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

OFFICE OF PUBLIC AFFAIRS Contact: Carolyn Johnston
(202) 634-5377

FOR IMMEDIATE RELEASE April 1, 1980

TREASURY SECRETARY MILLER APPOINTS JOSEPH A. MCELWAIN
AS NEW SAVINGS BONDS CHAIRMAN FOR MONTANA

Secretary of the Treasury G. William Miller has appointed Joseph A. McElwain, Chairman of the Board, Chief Executive Officer and Director of the Montana Power Company, as Volunteer State Chairman for the Savings Bonds Program in Montana. The appointment is effective immediately.

He succeeds William B. Andrews, President, Northwest Bank of Helena.

Mr. McElwain will head a committee of business, banking, labor, government and media leaders who, in cooperation with the U.S. Savings Bonds Division, will assist in promoting bond sales throughout the state.

Mr. McElwain, a native of Deer Lodge, Montana, has received B.A., LL.B and JD degrees from the University of Montana. He joined the Montana Power Company in 1954 as Washington Legislative Counsel,

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serving in that capacity until 1963, when he became Counsel for the company. Mr. McElwain subsequently became Vice President, Executive Vice President, and President.

He was elected to his present positions in 1979.

Mr. McElwain has been a director of the National Association of Electric Companies; First Metals Bank & Trust Company; Pacific Northwest Power Company, and the Butte Cultural Arts Board. He has also served on the Advisory and Policy Committees of the Edison Electric Institute and the Business Administration Advisory Council of the University of Montana..

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WASHINGTON, D.C. 20220 TELEPHONE 566-2041

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(202) 634-5377

FOR IMMEDIATE RELEASE March 29, 1980

TREASURY SECRETARY MILLER NAMES HORATIO MASON
SAVINGS BONDS CHAIRMAN FOR KENTUCKY

Horatio P. Mason, Vice Chairman of the Board and Treasurer, Mason & Hanger-Silas Mason Company, Inc., has been appointed Kentucky Volunteer State Chairman for the Savings Bonds Program by Secretary of the Treasury G. William Miller. The appointment is effective immediately.

He succeeds Charles I. McCarty, Chairman of the Board and Chief Executive Officer, Brown & Williamson Tobacco Corporation.

Mr. Mason will head a committee of business, banking, labor, government and media leaders who, in cooperation with the U.S. Savings Bonds Division, will assist in promoting bond sales throughout the state.

Mr. Mason joined Mason & Hanger after graduation from Virginia Military Institute. He worked in New York City and Philadelphia before moving to Kentucky to manage the company's Hartland Farm.

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In 1962 Mr. Mason was elected Vice President of Mason & Hanger-Silas Mason Co., Inc. He became Vice President and Treasurer in 1966 and Vice Chairman and Treasurer in 1976.

Mr. Mason is the great grandson of Claiborne Rice Mason, who founded the company in 1827.
