U. S. Dept. of the Treasury.

T. PRESS RELEASES

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. December 22, 1981

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $9,800 million, to be issued December 31, 1981. This offering will provide $ 1,250 million of new cash for the Treasury, as the maturing bills were originally issued in the amount of $8,542 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 4,900 million, representing an additional amount of bills dated October 1, 1981, and to mature April 1, 1982 (CUSIP No. 912794 AK 0), currently outstanding in the amount of $ 4,513 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 4,900 million, to be dated December 31, 1981, and to mature July 1, 1982 (CUSIP No. 912794 AV 6).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing December 31, 1981. In addition to the maturing 13-week and 26-week bills, there are $ 4,518 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Federal Reserve Banks, as agents for foreign and international monetary authorities, currently hold $ 2,154 million, and Federal Reserve Banks for their own account hold $ 3,286 million of the maturing bills. These amounts represent the combined holdings of such accounts for the three issues of maturing bills.

Tenders from Federal Reserve Banks for themselves and as agents for 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 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $1,534 million of the original 13-week and 26-week issues.

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.

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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, December 28, 1981. 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 as of 12:30 p.m. Eastern time on the day of 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 December 31, 1981, in cash or other immediately-available funds or in Treasury bills maturing December 31, 1981. 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 Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of. Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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.

TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. December 22, 1981

TREASURY OFFERS $3,000 MILLION OF 163-DAY
CASH MANAGEMENT BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $3,000 million of 163-day Treasury bills to be issued January 5, 1982, representing an additional amount of bills dated June 18, 1981, maturing June 17, 1982 (CUSIP No. 912793 7J 9).

Competitive tenders will be received at all Federal Reserve Banks and Branches up to 1:30 p.m., Eastern Standard time, Tuesday, December 29, 1981. 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. 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.

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 as of 12:30 p.m., Eastern time, on the day of the auction. Such positions would include bills acquired through "when issued" trading, 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, January 5, 1982.

Under Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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 may be obtained from any Federal Reserve Bank or Branch.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE December 22, 1981

RESULTS OF AUCTION OF 4-YEAR NOTES

The Department of the Treasury has accepted $3,251 million of $ 7,492 million of tenders received from the public for the 4-year notes, Series K-1985, auctioned today. The notes will be issued December 31, 1981, and mature December 31, 1985.

The interest coupon rate on the notes will be 14-1/8%. The range of accepted competitive bids, and the corresponding prices at the 14-1/8% coupon rate are as follows:

	Bids	Prices
Lowest yield	14.09% a/	100.104
Highest yield	14.22%	99.718
Average yield	14.16%	99.896

Tenders at the high yield were allotted 46%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 30,301	$ 15,301
New York	6,322,493	2,791,453
Philadelphia	33,200	23,200
Cleveland	90,869	65,469
Richmond	30,827	30,327
Atlanta	19,321	19,321
Chicago	589,574	144,474
St. Louis	48,193	44,673
Minneapoli		
Kansas Cit		
Dallas		
San Franci		
Treasury		
Total		

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14 1/8% TREASURY NOTES OF SERIES K-1985

DATE: 12/22/81

HIGHEST SINCE:

LAST ISSUE: 9/23/81

15 % COUPON RATE

14.91 % AVERAGE YIELD

LOWEST SINCE: 6/23/81

14 % COUPON RATE

14.04% AVERAGE YIELD

TODAY:

14 1/8 % COUPON RATE

14.16% AVERAGE YIELD

R-544

TREASURY NEWS
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Remarks
by
The Honorable Beryl W. Sprinkel
Under Secretary for Monetary Affairs
Department of the Treasury
before the
"Charlotte County Business Forum"
Punta Gorda, Florida
December 29, 1981

I am delighted to be here with you and to be amongst friends in the warm Florida sunshine.

It's not only good to spend a few days away from the chill of the northern winter. It's good to put some distance for a moment between us and the distorting jungle of rhetoric in Washington that ebbs and flows up there like the tide on the Potomac.

Someone once described Washington as an enclave surrounded on four sides by reality. Well, it's nice to be back in reality with you.

The Reagan program is coming under some pretty heavy fire these days and I think it is important to sort out clearly the myth from the reality.

Those who are saying the Reagan program has failed have gotten themselves lost -- either intentionally or not -- in the fog of their own myths.

The first myth being bandied about is that the Reagan program has caused the current recession. Now if the subject weren't so serious, that would be funny.

Let's look at the facts. Rapid growth in the money supply results in inflation and inflation, in turn, leads to high interest rates.

This is not Beryl Sprinkel's pet theory. And it is not supply side economic theory. It is a fact. And it is a situation caused by years of spend-and-spend government philosophy and monetizing the debt.

We Republicans may not be perfect; but - contrary to many of our critics - we are smart enough to study and learn from history. And history teaches us that rapid growth in money goes hand-in-hand with inflation. Those who think this is not so are simply blind to the hard cold evidence. Similarly, inflation and inflationary expectations lead to high interest rates. This would also be abundantly evident to our liberal, Keynesian friends if they would take the time to look at some numbers and some correlations.

During the four years of the Carter Administration, the Fed pumped out new money at almost 8% per year - far in excess of the rate of growth of the economy. That produced high inflation and inflationary expectations and interest rates went up as a consequence. We all know the resulting impact on business.

Economics has been called the dismal science. And some of it can get a bit arcane. But it seems more puzzling than it really is because of all the misleading rhetoric. The prevailing view -- you hear it constantly -- is that tight money has caused high interest rates. But a careful look at history indicates that exactly the opposite is true: rapid money growth results in inflation and high interest rates. Slow money growth brings interest rates down. Economists can argue theory 'til the cows come home. But what is really important to you and me is what actually happens in the economy. And what is actually happening is inflation and interest rates went up with the policies of the past Administration and are coming down with our policies.

This Administration is a low interest rate Administration. And the results of our intentions are clear from the significant declines in almost all the major rates.

That's myth number one. Myth number two is that next year's budget deficits are going to cause renewed inflation and high interest rates. That keeps getting repeated like a broken record; but, again, the historical evidence says otherwise.

Japan and Germany both have much larger government deficits -- as a percentage of GNP -- than we do. Yet they have relatively low inflation, low interest rates and high rates of real growth. Why? Primarily because their rates of savings and investment are 3 times and 4 times the rate here and because they have exercised monetary discipline.

We are not suggesting suddenly that deficits are now alright. They are not alright.

But what we are saying is that the method used to move toward a balanced budget is critically important. Why? Because we are not only trying to make sure expenditures and receipts balance out on a tally sheet. We also must reduce government spending as a percentage of GNP. That is the key to growth. And the message we need to get across is this: The budget not only has to be balanced; it has to be smaller. That is why budget reductions on Capitol Hill are so essential. And you can help out in this. Congress, you know, doesn't have to see the light; they just have to feel the heat!

Given the economic mess that this Administration inherited, we are faced with a stark choice: (1) keep the tax cuts in place, continue the pressure to cut spending and - realistically - accept large deficits in the near term; (2) raise taxes again to shrink the deficit and thereby kill off the savings/ investment stimulus for economic growth; (3) or increase the money supply, re-inflate the economy, thereby increasing revenues to shrink the deficit.

The first option addresses the over-riding priority of getting real growth up in this country. Furthermore, as we build a larger pool of savings, the negative impact of servicing the deficit from that pool can be minimized.

Now the last -- and perhaps the most insidious myth -- is that Reaganomics is some sort of new fangled theory that has never been tried before. I will admit that we have been under the influence of Keynesian demand-management economics for so long that it seems as though our ideas have never been tried. But the intellectual underpinnings of the Reagan program are not only centuries old -- they have been tried and tested. And they work. The French economist, Jean Babtiste Say claimed almost 200 years ago that "supply creates its own demand" and John Stuart Mill foresaw supply-side economics when America was in its infancy as he wrote that high tax rates would "discourage industry by insufficiency of reward."

Successful economies have demonstrated time after time that you get growth and prosperity from the the hard work and dedication of our private citizens and our agricultural and business communities. And that governments either help or hinder that process to the extent they allow the incentive and free market system to operate.

So those who claim that the program isn't working are either deceitful or terribly misinformed.

This is the Sunshine State, so lets talk about the sun for a minute. What if I stood here and tried to convince you that when the sun comes up in the morning the air temperature goes down? You would think I was nuttier than a Christmas fruitcake. But that is just about what our liberal friends are trying to do. They repeat their theories without looking at the real world.

Our program is long-term and comprehensive; and it has barely begun. The first and smallest round of tax cuts has been in effect less than 90 days. The truly significant cuts will not begin until next summer.

To say our policies aren't working is like saying -- while the openning kick-off is still in the air -- that the Miami Dolphins are behind. In the last few months, inflation has come down. Interest rates are down; and there is already an improvement in the rate of personal savings. Wait until the market place really catches those tax incentives and starts to run, before passing judgement on which way the game is going.

The economic mess that we inherited could hardly have been worse. And it is going to take some time to turn this thing around.

It is always very tempting to lunge for the quick-fix -- particularly as we move into an election year. But the quick fixes of the past have always made things worse in the long run. And we are simply not going to go down that road again. Ronald Reagan was elected because the American people sensed it was time for long-term significant changes in economic policy. And we are honor bound not to cave in to short-term political expediency but to stay on the long-term course that will lead to sustained non-inflationary growth.

You know the old saying: "When the going gets tough, the tough get going." You all are strong and dedicated and energetic. You would not be business and community leaders if you were not.

After decades of vascillation, fiddle faddling and irresponsible leadership, this President has gotten the nation pointed back in the right direction.

Those of us in positions of leadership carry a special responsibility always to separate the myth from the reality.

So I implore you to "hang tough", as they say, -- not for a quick economic boomlet next week or next month -- but for an economic system in America that will be truly revitalized.

Thank you for your commitment and your perseverance. We are convinced that this really is a new beginning.

FOR IMMEDIATE RELEASE DECEMBER 21, 1981

The Treasury announced today that the 2-1/2 year Treasury yield curve rate for the five business days ending December 21, 1981, averaged 13.45% rounded to the nearest five basis points. Ceiling rates based on this rate will be in effect from Tuesday, December 22, 1981 through Monday January 4, 1982.

Detailed rules as to the use of this rate in establishing the ceiling rates for small saver certificates were published in the Federal Register on July 17, 1981.

Small saver ceiling rates and related information is available from the DIDC on a recorded telephone message. The phone number is (202)566-3734.

Approved ________________________

Francis X. Cavanaugh
Acting Director
Office of Market Analysis
& Agency Finance

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TREASURY NEWS

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FOR RELEASE UPON DELIVERY
December 16, 1981

STATEMENT BY THE HONORABLE JOHN M. WALKER, JR.
ASSISTANT SECRETARY (ENFORCEMENT & OPERATIONS)
U.S. TREASURY DEPARTMENT
BEFORE THE
SUBCOMMITTEE ON CRIME
OF THE
HOUSE COMMITTEE ON THE JUDICIARY

Mr. Chairman and Members of the Subcommittee:

When I last testified before this Committee on October 1, 1981, no decision had been made within the Treasury Department regarding the ultimate status of the Bureau of Alcohol, Tobacco and Firearms. Since that time, a decision was reached and announced on November 12. A plan has been drawn up whereby the firearms and explosives enforcement functions of ATF would be reassigned to the U.S. Secret Service and the alcohol and tobacco revenue collection and regulatory functions and personnel would be reassigned to the U.S. Customs Service.

After thorough study, the Department determined that there is no longer any valid reason for having the functions of the enforcement of firearms and explosives laws in the same bureau responsible for alcohol and tobacco revenue collection and regulation. These functions are separate, have no commonality of purpose and compete with each other for resources.

R-545

I believe that considerable efficiencies can be realized by the reassignment of functions. The organizational structure which exists today, particularly in the criminal enforcement area, is based on the earlier needs of a Bureau which concentrated its resources on the production of illicit alcohol. While it may have been valid in the past, this structure no longer serves a useful law enforcement purpose.

To ensure the more effective use of available resources, we intend to close certain offices, realign regulatory functions in the firearms and explosives area under the control of criminal enforcement and reduce administrative overhead by the reassignment of functions to Customs and the Secret Service.

The plan which has been formulated would reassign approximately 1730 ATF personnel to the Secret Service to carry out the criminal enforcement and regulatory functions of firearms and explosives. The breakdown would be 1200 agents and 530 administrative, clerical and technical support personnel. Approximately 900 agents would be involved in firearms enforcement while 300 would work in explosives enforcement. The 530 support personnel would enable the Secret Service to continue the vital functions of firearms tracing, processing of applications for dealer licenses and forensic laboratory support for criminal enforcement activities.

Under this plan, I am confident that firearms enforcement can be more productive against criminal traffickers even with fewer personnel by reassigning agents to areas where they are most needed, and concentrating our efforts on the criminal misuse of firearms. The number of personnel reassigned to explosives enforcement will enable the Secret Service to continue to pursue major arson cases which are an outgrowth of the explosives statutes.

The alcohol and tobacco functions of ATF would be reassigned to the U.S. Customs Service with funding for 719 personnel. This arrangement would provide for limited enforcement of the Federal Alcohol Administration Act. Approximately 60 criminal enforcement agents would be reassigned to the Customs Service to investigate violations connected with the production of illicit alcohol and cigarette smuggling. These activities have diminished in recent years. "Moonshining" or illicit alcohol has virtually been eradicated by past efforts of ATF. Tobacco smuggling enforcement will be turned back to the states, but Customs will retain the capability to assist the states in the event it becomes necessary.

The Customs Service's receipt of the excise tax and regulatory functions of ATF pertaining to alcohol and tobacco is a sound management decision. Both agencies collect substantial revenues, maintain laboratories for testing commodities, utilize all-in-bond procedures and have significant regulatory responsibilities.

The plan to reassign firearms and explosives criminal law enforcement functions presently being performed by ATF is also motivated by significant urgent needs of the Secret Service. First and foremost of these is a need which the Service has for additional resources in its protective effort. This was one of the major findings of a management review of the Secret Service which the Department conducted following the assassination attempt on March 30, 1981. The Secret Service in FY 1981 (a non-campaign year) averaged 70 hours overtime per agent per month. This is far in excess of what should be expected from any work force and continuation of these levels will endanger the ability of agents to respond at a time of crisis. It should also be noted that the amount of overtime per agent per month rises substantially during campaign years.

The acquisition by the Service of the firearms and explosives functions of ATF would quickly give the Secret Service additional resources to draw on for its protective mission by ensuring that the Service has an available supplemental manpower pool at peak protective periods such as campaign years. It should be noted, for example, that during the 1980 Presidential Campaign approximately 600 ATF agents were detailed to the Secret Service at various times during the year.

Another major benefit to the Secret Service of the transfer of ATF functions would be an enhancement of its ability to gather intelligence on those individuals, hate groups and terrorists, who pose a threat to the life of the President and other Secret Service protectees. The very nature of ATF's work involving persons and groups who deal illegally in firearms and explosives ensures this fact. ATF frequently develops cases against terrorists, hate groups and other extremists who sometimes threaten or target Secret Service protectees for violent action.

The acquisition of ATF's firearms and explosives enforcement duties will greatly enhance Secret Service relations with state and local police. The Service needs such relationships to effectively carry out its protective mission. ATF is highly respected by state and local law enforcement authorities throughout the country. ATF's technical investigative expertise with explosives will improve the Secret Service's ability to deal with individuals and terrorist groups who utilize explosive devices. This is particularly important at a time when military authorities are cutting back the availability of explosives ordnance personnel to the Secret Service.

ATF is currently operating under a continuing resolution of $115 million. We expect that the needed level of appropriations to facilitate assignment of ATF's personnel and functions to the Secret Service and Customs will be acted upon in February.

Whatever budget figure is finally appropriated for FY 1982, it is the Treasury Department's intention to enforce the firearms and explosives statutes to the greatest extent possible because of the impact which these violations have on violent crime. We believe that effective enforcement in these areas can be accomplished with fewer people and greater productivity. Special attention in the firearms area will be concentrated on the following types of offenders: narcotics traffickers, stolen property fences, interstate traffickers, organized crime figures, international air traffickers, outlaw motorcycle gang members and terrorists. The explosives statutes will also continue to be enforced. Arson investigations will be continued with an emphasis on the concentration of resources in those situations and areas where there are arson-for-profit schemes involving commercial premises engaged in interstate commerce. We believe that this is the proper Federal role in arson investigations. We plan to put greater emphasis on the training of state and local officials to handle arson problems. We hope that this will enable some local jurisdictions to take over their own arson investigations, thereby reducing the need for ATF presence.

The Administration supports the transfer of ATF functions within the Treasury Department. There are real savings which will be achieved in the areas of administrative and managerial overhead, laboratory consolidation, shared communications and ADP systems, and common training programs if ATF functions are moved within Treasury. A transfer of the firearms and explosives functions of ATF within Treasury can be done without legislation.

The reassignment of ATF functions, within the Treasury Department, to the Secret Service and Customs Service has numerous practical advantages. ATF agents are selected from the same resource pool (the Treasury Enforcement Agent Exam), have similar entrance requirements and have the same basic training (Criminal Investigation School at FLETC) as Secret Service and Customs Agents. Mergers would be relatively easy to accomplish at the field and Headquarters level. Many ATF agents have had both training and practical experience in the protective duties of the Secret Service in connection with protective assignments during election years. ATF, Secret Service and Customs Agents all have common civil service status.

I question whether there is any overriding law enforcement interest or benefit to be derived from a transfer of the firearms and explosives functions of ATF to the Justice Department as proposed by H.R. 5043. I have no basis for assuming that such a transfer would result in improved firearms and explosives enforcement. On the other hand, the assignment of the firearms and explosives functions to the Secret Service would result in increased efficiency and productivity in the enforcement of these laws.

This completes my opening statement. I am now available to answer any questions which you may have.

TREASURY NEWS
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FOR IMMEDIATE RELEASE
December 23, 1981

CONTACT: George G. Ross
202/566-2041

TREASURY ANNOUNCES PUBLIC MEETING ON MODEL INCOME TAX TREATY

The Treasury Department today announced that a public meeting will be held on January 14, 1982 in Room 4121 of Main Treasury at 1:30 p.m. to discuss the provisions of Article 16 (Limitation on Benefits) of the draft U.S. Model Income Tax Treaty. The draft Model was released for public comment on June 16, 1981.

The Treasury has considered the comments submitted to it concerning Article 16 and the other provisions of the June 1981 draft Model and intends to publish a new Model in the near future. The Treasury has concluded that the new U.S. Model Income Tax Treaty and future U.S. income tax treaties will contain a provision such as Article 16 of the draft Model to assure that source basis tax benefits provided by a U.S. income tax treaty are not obtained improperly by residents of third countries.

The purpose of the January 14, 1982 meeting is to discuss specific provisions which might be used in Article 16 to achieve this objective. Examples of such provisions may be found in: Article 16 of the June 16, 1981 draft Model; Article 17 of the proposed Protocol to the proposed Income Tax Treaty between the United States and Jamaica; the proposed anti-abuse reservation to the proposed Income Tax Treaty between the United States and Argentina (attached); a discussion draft of Article 16 (attached). The Treasury invites interested parties to submit comments and/or further drafts of Article 16 for discussion at the January 14 meeting.

In practice U.S. tax treaties generally deviate to some extent from the U.S. Model due to the bilateral nature of a treaty. Any Article 16 adopted in the new U.S. Model would be modified in negotiations with a treaty partner to the extent necessary to take into account the nature of the treaty partner's system of taxation and the other provisions of the proposed income tax treaty with that country.

Consequently, one of the purposes of the meeting is not only to develop a Model provision but, also to consider appropriate variations for use in differing situations.

Treasury announced that the January meeting will cover possible methods for withholding agents and taxpayers to comply with the provisions of Article 16. In this context Treasury also invites comments on whether any reduction of U.S. tax available to foreign persons under U.S. tax treaties should in the future be provided solely by requiring eligible taxpayers to request a refund from the Internal Revenue Service, or by allowing U.S. withholding agents to reduce or eliminate withholding on the basis of a certification of foreign residence, IRS rulings, or forms and information supplied by a foreign taxpayer in support of his eligibility for the reduced rate.

Those intending to attend the January 14, 1982 meeting are requested to so advise A. W. Granwell, International Tax Counsel, Main Treasury Building, Washington, D.C. 20220 by January 8, 1982.

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Proposed Senate Reservation to Proposed Income Tax Treaty between the United States and Argentina

Reservation that, a person (other than an individual) which is a resident of a Contracting State and which derives income from sources within the other Contracting State shall not be entitled to the benefits under this Convention accorded by that other Contracting State if: 25 percent or more of the beneficial interest in such person is owned, directly or indirectly, by individuals who are not residents of the first-mentioned Contracting State. For purposes of this paragraph, a corporation that has substantial trading in its stock on a recognized exchange in a Contracting State is presumed to be owned by residents of that Contracting State. This paragraph shall not apply if it is determined that the acquisition or maintenance of such person and the conduct of its operations did not have as a principal purpose obtaining benefits under the Convention.

Discussion Draft

Article 16

Investment or Holding Companies

1. A corporation which is a resident of a Contracting State shall not be entitled under this Convention to relief from taxation in the other Contracting State with respect to an item of income, gains or profits unless the corporation establishes that:

a) its stock of any class is listed on an approved stock exchange in a Contracting State, or that it is wholly owned, directly or through one or more corporations each of which is a resident of a Contracting State, by a corporation the stock of which of any class is so listed; or

b) it is not controlled by a person or persons who are not residents of a Contracting State, other than citizens of the United States; or

c) it was not a principal purpose of the corporation or of the conduct of its business or of the acquisition or maintenance by it of the shareholding or other property from which the income in question is derived to obtain any of such benefits.

2. For the purposes of this Article:

a) an approved stock exchange in ________ means ________________________________;

b) an approved stock exchange in the United States means the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934;

c) a person or persons shall be treated as having control of a corporation if under the income tax laws of the Contracting

State in which the income arises the person or persons could be treated as having direct or indirect control of the corporation for any purpose;

d) notwithstanding subparagraph c) of this paragraph, a corporation is presumed to meet the requirements of subparagraph b) of paragraph 1 of this Article if the corporation establishes that individuals who are:

i) citizens of the United States;

ii) residents of a Contracting State; or

iii) residents of States that have income tax conventions in force with the Contracting State from which relief from taxation is claimed and such conventions provide relief from taxation not less than the relief from taxation claimed under this Convention;

own directly more than 75 percent of the total combined voting power of all classes of the corporation's stock entitled to vote and more than 75 percent of the number of shares of each other class of the corporation's stock;

e) a corporation is presumed to meet the requirements of subparagraph c) of paragraph 1 of this Article, in particular, where:

i) the reduction in tax claimed is not greater than the tax actually imposed by the Contracting State of which the corporation is resident;

ii) the corporation is engaged in business operations in the Contracting State of which it is a resident and the relief from taxation claimed from the other Contracting State is with respect to income which is incidental to or derived in connection with such business.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE　　　　December 23, 1981

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $ 5,251 million of 52-week bills to be issued December 31, 1981, and to mature December 30, 1982, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-issue Yield) 1/
High -	87.462	12.400%	13.89%
Low -	87.311	12.550%	14.08%
Average -	87.360	12.501%	14.02%

Tenders at the low price were allotted 96%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 39,385	$ 24,385
New York	8,347,060	4,712,380
Philadelphia	27,075	17,075
Cleveland	22,505	20,505
Richmond	21,260	17,560
Atlanta	7,800	7,800
Chicago	484,225	285,285
St. Louis	34,650	30,650
Minneapolis	2,355	2,355
Kansas City	7,980	7,980
Dallas	2,880	2,880
San Francisco	547,130	95,130
Treasury	26,935	26,935
TOTALS	$9,571,240	$5,250,920
Type		
Competitive	$7,850,135	$3,529,815
Noncompetitive	161,065	161,065
Subtotal, Public	$8,011,200	$3,690,880
Federal Reserve	1,200,000	1,200,000
Foreign Official Institutions	360,040	360,040
TOTALS	$9,571,240	$5,250,920

1/ The average annual investment yield is 14.51%. This requires an annual investment yield on All-Savers Certificates of 10.16%.

R-547

TREASURY NEWS
partment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
December 28, 1981

CONTACT: Leonora Cross
(202)287-4279

CONOVER SWORN IN AS COMPTROLLER OF THE CURRENCY

C.T. Conover took the oath of office on December 16, 1981 as twenty-fifth Comptroller of the Currency.

President Reagan nominated Conover to the post on November 13, 1981; on December 14, 1981, the U.S. Senate confirmed his appointment for a statutory 5-year term. Conover succeeds John G. Heimann, who resigned last April.

As Administrator of National Banks, the Comptroller supervises, regulates and examines some 4,470 federally-chartered banks throughout the United States. The examination functions of the Office are carried out through 13 regional offices across the country, as well as through offices abroad that examine more than 700 foreign branches of U.S. national banks.

A former management consultant, Conover has dealt extensively with commercial banks and other financial institutions and has concentrated on solving problems in the areas of strategic planning, financial management, and operations improvement.

Conover began his career as a management trainee with Seattle-First National Bank. He comes to the Comptroller's post from Edgar Dunn & Conover, Inc., a general management consulting firm in San Francisco, where he was one of the founding partners. Before that firm's establishment, he was with the management consulting group of Touche Ross & Co., San Francisco, where he was a principal and national services director for banking from 1974 to 1978. Prior to that, Conover served as vice president, corporate development, for U.S. Bancorp in Portland, Oregon. He was a management consultant with the offices of McKinsey & Company, Inc., in San Francisco and Amsterdam, The Netherlands, from 1965 to 1972.

After receiving a B.A. from Yale University in 1960, Conover served for two years in the U.S. Navy on active duty. In 1965 he received his M.B.A. in finance from the University of California at Berkeley.

R-548

# # #

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

FOR IMMEDIATE RELEASE December 28, 1981

FEDERAL FINANCING BANK ACTIVITY

Francis X. Cavanaugh, Acting Secretary, Federal Financing Bank (FFB), announced the following activity for the month of November 1981.

FFB holdings of obligations issued, sold, or guaranteed by other Federal agencies on November 30, 1981 totaled $109.5 billion, an increase of $1.3 billion over October 31. FFB increased holdings of agency debt issues by $0.1 billion, holdings of agency guaranteed debt by $0.7 billion, and holdings of agency assets purchased by $0.5 billion. A total of 162 disbursements were made during the month.

On November 10, FFB committed to lend $1.1 billion to the TOSCO Oil Shale Project. Repayment of funds advanced under this commitment is guaranteed by the Department of Energy pursuant to the Defense Production Act.

Attached to this release is a table outlining FFB loan activity during November, a table outlining new FFB commitments to lend and a table summarizing FFB holdings as of November 30, 1981.

R-549 # 0 #

FEDERAL FINANCING BANK

NOVEMBER 1981 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF DEFENSE					
Greece 13	11/2	$ 246,711.00	9/22/90	14.248%	
Turkey 7	11/2	14,011,693.00	6/3/91	14.833%	
Egypt 1	11/4	24,105,651.56	9/1/09	14.718%	
Greece 13	11/4	246,711.00	9/22/90	14.712%	
Peru 5	11/4	132,393.75	3/15/86	14.600%	
Spain 4	11/4	4,344,983.30	4/25/90	14.705%	
Spain 5	11/4	4,514,582.00	6/15/91	14.718%	
Tunisia 8	11/4	344,980.00	7/10/88	14.675%	
Korea 14	11/5	35,766,671.44	6/30/93	14.351%	
Spain 3	11/6	918,885.70	9/25/89	14.449%	
Spain 5	11/6	638,654.50	4/25/90	14.438%	
Egypt 1	11/6	107,883.75	9/1/09	14.357%	
Morocco 8	11/10	10,995,650.00	9/21/93	13.565%	
Uruguay 2	11/10	23,000.00	12/31/84	13.230%	
Jamaica 1	11/12	594,370.01	3/1/93	13.621%	
Spain 3	11/12	3,024,759.00	9/25/89	13.599%	
Spain 4	11/12	3,089,913.84	4/25/90	13.599%	
Spain 5	11/12	13,592,105.47	6/15/91	13.611%	
Sudan 2	11/12	579,262.78	6/3/10	13.699%	
Sudan 3	11/12	2,023,915.00	2/24/11	13.702%	
Israel 8	11/16	176,224,074.00	9/1/09	13.429%	
Philippines 6	11/16	44,218.03	7/21/85	12.960%	
Egypt 1	11/17	13,967,476.71	9/1/09	13.303%	
Israel 8	11/17	25,000,000.00	9/1/09	13.303%	
Jordan 5	11/17	1,377,105.49	3/30/88	13.185%	
Turkey 6	11/17	74,569.00	6/3/88	13.150%	
Turkey 9	11/17	152,174.00	6/22/92	13.276%	
Turkey 11	11/17	37,301.00	12/22/10	13.298%	
Liberia 6	11/18	17,770.65	3/21/86	12.966%	
Colombia 4	11/20	18,495.00	7/10/86	12.754%	
Egypt 1	11/20	3,638,687.00	9/1/09	13.240%	
Greece 13	11/20	99,050.00	9/22/90	13.050%	
Turkey 7	11/20	4,291.89	6/3/91	13.131%	
Turkey 8	11/20	44,038.00	6/15/10	13.239%	
Turkey 12	11/20	233.00	5/5/11	13.241%	
Turkey 8	11/23	6,000,000.00	6/15/10	13.283%	
Turkey 10	11/23	2,900,000.00	10/5/92	13.217%	
Turkey 11	11/23	536,662.60	12/22/10	13.282%	
Egypt 1	11/24	8,579,421.29	9/1/09	13.545%	
Philippines 6	11/24	547,575.86	7/21/85	12.834%	
Korea 14	11/27	12,367,967.10	6/30/93	12.927%	
DEPARTMENT OF ENERGY (Defense Production Act)					
Synthetic Fuels Guarantees					
TOSCO #1A	11/10	22,212,150.68	10/1/07	13.706%	
TOSCO #1B	11/12	1,000,000.00	10/1/07	13.706%	
TOSCO #2	11/16	2,732,488.98	10/1/07	13.436%	
TOSCO #3	11/23	1,750,595.98	10/1/07	13.282%	
TOSCO #4	11/30	1,576,453.80	10/1/07	12.987%	
FARMERS HOME ADMINISTRATION					
Certificates of Beneficial Ownership	11/25	375,000,000.00	11/25/96	13.265%	13.705% ann.
	11/25	75,000,000.00	11/25/01	13.265%	13.705% ann.
GENERAL SERVICES ADMINISTRATION					
Series M-079	11/6	604,518.73	6/26/03	14.394%	
DEPARTMENT OF HEALTH & HUMAN SERVICES					
Health Maintenance Organization Notes					
Block #18	11/25	1,991,202.76	various	13.430%	

FEDERAL FINANCING BANK

NOVEMBER 1981 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT					
Community Development Block Grant Guarantees					
*Indianapolis, Indiana	11/2	446,000.00	10/31/83	14.573%	15.104% ann.
Sacramento, California	11/17	250,000.00	9/1/82	12.165%	12.434% ann.
Public Housing Authority Project Bonds					
Sale #15	11/6	101,805,744.88	various	15.578%	16.185% ann.
RURAL ELECTRIFICATION ADMINISTRATION					
*Medina Electric #113	11/2	757,000.00	11/2/83	14.715%	14.454% qtr.
*Colorado Ute Electric #78	11/2	3,328,000.00	11/2/83	14.715%	14.454% "
Arkansas Electric #142	11/2	7,578,000.00	11/2/83	14.715%	14.454% "
Saluda River Electric #186	11/2	1,728,000.00	11/2/83	14.715%	14.454% "
New Hampshire Electric #192	11/2	100,000.00	11/2/83	14.715%	14.454% "
South Texas Electric #200	11/2	724,000.00	11/2/83	14.715%	14.454% "
United Power #139	11/2	2,900,000.00	11/2/83	14.715%	14.454% "
South Mississippi Electric #171	11/2	2,500,000.00	11/3/83	14.715%	14.454% "
Brookville Telephone #53	11/2	693,000.00	12/31/15	14.559%	14.303% "
Colorado Ute Electric #71	11/4	2,387,000.00	11/4/83	14.565%	14.309% "
Brazos Electric #108	11/4	1,555,000.00	11/4/83	14.565%	14.309% "
Brazos Electric #144	11/4	1,284,000.00	11/4/83	14.565%	14.309% "
Hoosier Energy #107	11/5	20,000,000.00	11/5/83	14.235%	13.990% "
*United Power #67	11/5	700,000.00	11/5/83	14.235%	13.990% "
*United Power #129	11/5	1,050,000.00	11/5/83	14.235%	13.990% "
Seminole Electric #141	11/6	2,048,000.00	11/6/84	14.355%	14.106% "
Sunflower Electric #174	11/6	15,000,000.00	11/6/83	14.325%	14.077% "
*West Virginia Telephone #17	11/7	1,000,000.00	11/7/83	13.985%	13.749% "
*Continental Tele. of Kentucky #47	11/8	1,500,000.00	11/8/83	13.985%	13.749% "
*South Texas Electric #109	10/8	1,232,000.00	11/8/83	13.985%	13.749% "
*Cooperative Power #5	11/9	2,500,000.00	11/9/84	14.005%	13.768% "
*Western Illinois Power #99	11/9	1,943,000.00	11/9/83	13.985%	13.749% "
*Basin Electric #87	11/9	374,000.00	11/9/83	13.985%	13.749% "
*Colorado Ute Electric #8	11/9	2,708,000.00	11/9/83	13.985%	13.749% "
Western Illinois Power #162	11/9	2,702,000.00	11/9/83	13.985%	13.749% "
Northern Michigan Electric #101	11/10	50,000.00	11/10/83	13.295%	13.081% "
Northern Michigan Electric #183	11/10	3,447,000.00	11/10/83	13.295%	13.081% "
Colorado Ute Electric #168	11/10	13,500,000.00	11/10/83	13.295%	13.081% "
Walash Valley Power #104	11/10	2,687,000.00	11/10/83	13.295%	13.081% "
Wolverine Electric #182	11/10	2,722,000.00	11/10/84	13.375%	13.159% "
Allegheny Electric #175	11/10	4,384,000.00	11/30/84	13.385%	13.168% "
Oglethorpe Power #74	11/12	13,625,000.00	11/12/83	13.345%	13.130% "
Oglethorpe Power #150	11/12	14,639,000.00	11/12/83	13.345%	13.130% "
*Western Farmers Electric #64	11/13	675,000.00	11/13/83	12.895%	12.694% "
*Western Farmers Electric #126	11/13	1,000,000.00	11/13/83	12.895%	12.694% "
*Western Farmers Electric #133	11/13	14,125,000.00	11/13/83	12.895%	12.694% "
*Brazos Electric #108	11/13	2,500,000.00	11/13/83	12.895%	12.694% "
*Wolverine Electric #100	11/13	1,989,000.00	11/13/84	12.975%	12.771% "
Cajun Electric #197	11/13	40,000,000.00	11/13/83	12.895%	12.694% "
*Colorado Ute Electric #78	11/14	8,782,000.00	11/14/83	12.895%	12.694% "
*East Kentucky Power #73	11/15	6,790,000.00	11/15/83	12.955%	12.752% "
*Central Electric Power #131	11/15	170,000.00	11/15/83	12.955%	12.752% "
New Hampshire Electric #192	11/16	3,000,000.00	11/16/83	12.955%	12.752% "
Western Farmers Electric #64	11/16	400,000.00	11/16/83	12.955%	12.752% "
Western Farmers Electric #126	11/16	3,772,000.00	11/16/83	12.955%	12.752% "
Western Farmers Electric #133	11/16	8,128,000.00	11/16/83	12.955%	12.752% "
East Kentucky Power #188	11/16	5,800,000.00	11/16/83	12.955%	12.752% "
Tri-State G&T #177	11/16	1,250,000.00	10/31/88	13.485%	13.265% "
Tri-State G&T #177	11/16	325,000.00	10/31/88	13.485%	13.265% "
Associated Electric #132	11/17	10,000,000.00	11/17/83	12.815%	12.616% "
East Kentucky Power #73	11/17	2,500,000.00	11/17/83	12.815%	12.616% "
Colorado Ute Electric #152	11/17	1,080,000.00	11/17/83	12.815%	12.616% "
Chugach Electric #204	11/17	2,307,000.00	12/31/15	13.267%	13.054% "
Seminole Electric #141	11/18	4,663,000.00	11/18/84	12.975%	12.771% "
Cooperative Power #5	11/19	260,000.00	11/19/84	12.775%	12.577% "

*Maturity extension

FEDERAL FINANCING BANK

NOVEMBER 1981 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
*St. Joseph Tel. & Tel. #13	11/19	1,177,000.00	11/21/83	12.315%	12.131% qtr.
Big Rivers Electric #91	11/20	416,000.00	11/20/83	12.345%	12.160% "
Big Rivers Electric #136	11/20	73,000.00	11/20/83	12.345%	12.160% "
Big Rivers Electric #143	11/20	47,000.00	11/20/83	12.345%	12.160% "
Big Rivers Electric #179	11/20	19,939,000.00	11/20/83	12.345%	12.160% "
*Big Rivers Electric #58	11/20	1,590,000.00	11/20/83	12.345%	12.160% "
*Big Rivers Electric #91	11/20	5,423,000.00	11/20/83	12.345%	12.160% "
*Big Rivers Electric #136	11/20	699,000.00	11/20/83	12.345%	12.160% "
South Mississippi Electric #3	11/21	145,000.00	11/21/84	12.755%	12.558% "
Wabash Valley Power #206	11/23	694,000.00	11/23/83	12.335%	12.150% "
East River Electric #177	11/24	1,200,000.00	11/24/83	12.625%	12.432% "
North Carolina Electric #185	11/24	3,004,000.00	11/24/83	12.625%	12.432% "
Sunflower Electric #174	11/25	15,000,000.00	11/25/83	12.275%	12.092% "
*Associated Electric #132	11/26	14,200,000.00	11/26/83	12.225%	12.073% "
Allied Telephone of Arkansas #15	11/27	1,200,000.00	12/31/15	12.988%	12.784% "
Boone County Telephone #18	11/27	350,000.00	12/31/15	12.988%	12.784% "
*Golden Valley Electric #81	11/28	3,000,000.00	11/28/83	12.235%	12.053% "
*Basin Electric #88	11/28	1,751,000.00	11/28/84	12.675%	12.480% "
*United Power #86	11/29	375,000.00	11/29/83	12.235%	12.053% "
*Dairyland Power #54	11/30	1,187,000.00	11/30/83	12.235%	12.053% "
*Basin Electric Power #87	11/30	295,000.00	11/30/83	12.235%	12.053% "
*Arkansas Electric #97	11/30	5,910,000.00	11/30/83	12.235%	12.053% "
*Allegheny Electric #93	11/30	3,119,000.00	11/30/84	12.675%	12.480% "
United Power #67	11/30	1,300,000.00	11/30/83	12.235%	12.053% "
United Power #129	11/30	3,000,000.00	11/30/83	12.235%	12.053% "
Tri-State G&T #157	11/30	1,185,000.00	11/15/88	12.805%	12.606% "
Tri-State G&T #199	11/30	2,242,000.00	10/31/88	12.795%	12.597% "
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
San Antonio LDC, Inc.	11/4	61,000.00	12/1/96	14.711%	
Bay Area Emp. Dev. Co.	11/4	116,000.00	12/1/96	14.711%	
Louisville Econ. Dev. Corp.	11/4	196,000.00	12/1/96	14.711%	
LDC for Buffalo, N.Y.	11/4	230,000.00	12/1/96	14.711%	
Ocean State Bus. Dev. Authority	11/4	500,000.00	12/1/96	14.711%	
Ocean State Bus. Dev. Authority	11/4	70,000.00	12/1/01	14.770%	
Forward Development Corp.	11/4	110,000.00	12/1/01	14.770%	
Allentown Economic Dev. Corp.	11/4	111,000.00	12/1/01	14.770%	
New Orleans Citywide Dev. Corp.	11/4	139,000.00	12/1/01	14.770%	
Bay Area Employment Dev. Corp.	11/4	140,000.00	12/1/01	14.770%	
South Shore Economic Dev. Corp.	11/4	156,000.00	12/1/01	14.770%	
Plymouth Industrial Dev. Corp.	11/4	330,000.00	12/1/01	14.770%	
Long Island Dev. Corp.	11/4	498,000.00	12/1/06	14.749%	
Ocean State Bus. Dev. Authority	11/4	135,000.00	12/1/06	14.749%	
Small Business Investment Company Debentures					
S&S Ventures Associates, Ltd.	11/18	500,000.00	11/1/86	13.335%	
Western Financial Cap. Corp.	11/18	980,000.00	11/1/86	13.335%	
Fifty-Third St. Ventures, Inc.	11/18	2,460,000.00	11/1/91	13.195%	
Noro Capital Corp.	11/18	1,000,000.00	11/1/91	13.195%	
SPACE COMMUNICATIONS COMPANY (NASA Guaranteed)					
	11/20	6,300,000.00	10/1/92	13.124%	13.555% ann.
TENNESSEE VALLEY AUTHORITY					
Note #218	11/6	285,000,000.00	2/5/82	12.910%	
Note #219	11/13	35,000,000.00	2/5/82	11.251%	
Note #220	11/20	10,000,000.00	2/5/82	10.516%	
Note #221	11/30	45,000,000.00	12/4/81	10.588%	
Seven States Energy Corporation (TVA Guaranteed)					
Note A-82-02	11/30	345,618,287.05	2/26/82	10.588%	

FEDERAL FINANCING BANK

NOVEMBER 1981 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF TRANSPORTATION					
National Railroad Pasenger Corp. (Amtrak)					
Note #29	11/12	5,500,000.00	1/4/82	11.715%	
Note #29	11/20	4,800,000.00	1/4/82	10.609%	
Section 511					
Chicago & North Western #2	11/6	37,989.00	5/1/86	14.926%	15.483% ann.

FEDERAL FINANCING BANK

NOVEMBER 1981 COMMITMENTS

BORROWER	AMOUNT	GUARANTOR	COMMITMENT EXPIRES	MATURITY
The Oil Shale Corp. (TOSCO)	$1,112,400 000	DOE	10/1/89	10/1/07
Sacramento County, California	500,000	HUD	9/1/82	9/1/87
Urban Redevelopment Authority of Pittsburgh	2,000,000	HUD	10/15/82	10/15/02
Washington County, Penna.	2,500,000	HUD	9/15/82	9/15/82

FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)

Program	November 30, 1981	October 31, 1981	Net Change 11/1/81-11/30/81	Net Change 10/1/81-11/30/81
On-Budget Agency Debt				
Tennessee Valley Authority	$11,240.0	$11,105.0	$135.0	$366.0
Export-Import Bank	12,409.3	12,409.3	-0-	-0-
NCUA-Central Liquidity Facility	92.6	97.1	-4.5	-8.7
Off-Budget Agency Debt				
U.S. Postal Service	1,288.0	1,288.0	-0-	-0-
U.S. Railway Association	200.1	200.1	-0-	-14.9
Agency Assets				
Farmers Home Administration	49,021.0	48,571.0	450.0	200.0
DHHS-Health Maintenance Org.	118.5	116.5	2.0	2.0
DHHS-Medical Facilities	150.5	150.5	-0-	-0-
Overseas Private Investment Corp.	26.6	26.6	-0-	-0-
Rural Electrification Admin.-CBO	2,595.3	2,595.3	-0-	-0-
Small Business Administration	65.6	66.6	-1.0	-1.7
Government-Guaranteed Loans				
DOD-Foreign Military Sales	9,596.7	9,241.5	355.2	449.1
DEd.-Student Loan Marketing Assn.	4,600.0	4,600.0	-0-	300.0
DOE-Geothermal Loans	22.4	22.4	-0-	5.4
DOE-Hybrid Vehicles	2.2	2.2	-0-	0.1
DOE-Synthetic Fuels	29.3	-0-	29.3	29.3
DHUD-Community Dev. Block Grant	74.0	74.7	-0.7	-0.2
DHUD-New Communities	33.5	33.5	-0-	-0-
DHUD-Public Housing Notes	1,078.3	1,013.2	65.1	149.8
General Services Administration	412.6	412.7	-0.1	-0-
DOI-Guam Power Authority	36.0	36.0	-0-	-0-
DOI-Virgin Islands	29.9	29.9	-0-	-0-
NASA-Space Communications Co.	651.7	645.4	6.3	14.0
Rural Electrification Admin.	12,923.8	12,674.4	249.4	580.9
SBA-Small Business Investment Cos.	613.7	610.4	3.3	9.8
SBA-State/Local Development Cos.	8.4	5.8	2.6	3.2
TVA-Seven States Energy Corp.	973.2	939.9	33.3	59.0
DOT-Amtrak	835.5	825.2	10.3	55.7
DOT-Emergency Rail Svcs. Act	70.2	70.2	-0-	-0-
DOT-Title V, RRRR Act	119.4	122.3	-2.9	-4.2
DOT-WMATA	177.0	177.0	-0-	-0-
TOTALS*	$109,495.3	$108,162.8	$1,332.6	$2,194.6

*Figures may not total due to rounding

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE　　　　December 28, 1981

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 4,906 million of 13-week bills and for $ 4,900 million of 26-week bills, both to be issued on December 31, 1981, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 1, 1982			:	26-week bills maturing July 1, 1982		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	97.080 a/	11.552%	12.06%	:	93.762 b/	12.339%	13.34%
Low	97.032	11.742%	12.27%	:	93.687	12.487%	13.51%
Average	97.045	11.690%	12.21%	:	93.707	12.448% 2/	13.47%

a/ Excepting 1 tender of $250,000.
b/ Excepting 5 tenders totaling $1,320,000.
Tenders at the low price for the 13-week bills were allotted 28%.
Tenders at the low price for the 26-week bills were allotted 66%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 41,750	$ 36,500	:	$ 31,555	$ 26,555
New York	8,468,585	4,028,985	:	7,114,240	4,060,240
Philadelphia	77,195	27,195	:	12,505	12,505
Cleveland	80,950	50,950	:	28,645	23,645
Richmond	28,340	28,340	:	23,815	23,815
Atlanta	46,600	46,600	:	24,200	24,200
Chicago	875,255	329,255	:	532,150	135,450
St. Louis	20,890	18,890	:	22,370	18,370
Minneapolis	6,520	6,520	:	7,380	7,380
Kansas City	41,385	41,385	:	42,590	42,590
Dallas	22,545	22,545	:	8,095	8,085
San Francisco	562,130	84,730	:	607,510	387,510
Treasury	183,860	183,860	:	130,115	130,115
TOTALS	$10,456,005	$4,905,755	:	$8,585,170	$4,900,460
Type					
Competitive	$ 8,273,845	$2,723,595	:	$6,187,475	$2,502,765
Noncompetitive	741,670	741,670	:	482,195	482,195
Subtotal, Public	$ 9,015,515	$3,465,265	:	$6,669,670	$2,984,960
Federal Reserve	1,045,990	1,045,990	:	1,040,000	1,040,000
Foreign Official Institutions	394,500	394,500	:	875,500	875,500
TOTALS	$10,456,005	$4,905,755	:	$8,585,170	$4,900,460

1/ Equivalent coupon-issue yield
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 11.663%.

R-550

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. December 29, 1981

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $9,800 million, to be issued January 7, 1982. This offering will provide $1,225 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $8,577 million, including $ 1,068 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $ 1,726 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 $ 4,900 million, representing an additional amount of bills dated October 8, 1981 and to mature April 8, 1982 (CUSIP No. 912794 AL 8), currently outstanding in the amount of $ 4,546 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 4,900 million, to be dated January 7, 1982 and to mature July 8, 1982 (CUSIP No. 912794 BD 5).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing January 7, 1982. Tenders from Federal Reserve Banks for themselves and as agents for 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 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. 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.

R-551

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, January 4, 1982. 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 as of 12:30 p.m. Eastern time on the day of 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 January 7, 1982, in cash or other immediately-available funds or in Treasury bills maturing January 7, 1982. 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 Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of. Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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.

TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE December 29, 1981

RESULTS OF TREASURY'S AUCTION OF 163-DAY CASH MANAGEMENT BILLS

Tenders for $ 3,003 million of 163-day Treasury bills to be issued on January 5, 1982, and to mature June 17, 1982, 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 -	94.441	12.278%	13.18%
Low -	94.397	12.375%	13.29%
Average -	94.419	12.326%	13.24%

Tenders at the low price were allotted 71%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY
FEDERAL RESERVE DISTRICTS:
(In Thousands)

Location	Received	Accepted
Boston	$ 5,000	$ --
New York	6,895,000	2,699,600
Philadelphia	--	--
Cleveland	10,000	3,000
Richmond	6,000	--
Atlanta	--	--
Chicago	1,095,000	282,000
St. Louis	12,000	9,000
Minneapolis	--	--
Kansas City	--	--
Dallas	--	--
San Francisco	594,000	9,000
TOTALS	$8,617,000	$3,002,600

R-552

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE December 30, 1981

RESULTS OF AUCTION OF 20-YEAR 1-MONTH TREASURY BONDS

The Department of the Treasury has accepted $ 1,750 million of $ 4,847 million of tenders received from the public for the 20-year 1-month bonds auctioned today. The bonds will be issued January 6, 1982, and mature February 15, 2002.

The interest coupon rate on the bonds will be 14-1/4%. The range of accepted competitive bids, and the corresponding prices at the 14-1/4% coupon rate are as follows:

	Bids	Prices
Lowest yield	14.20%	100.229
Highest yield	14.27%	99.767
Average yield	14.25%	99.899

Tenders at the high yield were allotted 60%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 6,688	$ 688
New York	4,247,772	1,593,922
Philadelphia	503	503
Cleveland	10,936	9,336
Richmond	12,298	3,598
Atlanta	16,618	13,203
Chicago	355,571	81,321
St. Louis	27,002	22,252
Minneapolis	6,257	4,257
Kansas City	6,406	6,406
Dallas	3,047	2,047
San Francisco	154,305	12,505
Treasury	77	67
Totals	$4,847,480	$1,750,105

The $1,750 million of accepted tenders includes $ 353 million of noncompetitive tenders and $1,397 million of competitive tenders from private investors.

R-553

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
December 31, 1981

CONTACT: Mary Boswell Watkins
566-2041

GOLD COMMISSION TO MEET

The Gold Commission will hold its fifth meeting on January 8, 1981.

Treasury Secretary Donald T. Regan will chair the meeting which will be open to the public. The meeting will begin at 10:00 a.m. in the Cash Room of the Main Treasury Department Building in Washington, D.C. The public is advised to use the Pennsylvania Avenue entrance to the Treasury Department.

R-554

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE January 4, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 4,900 million of 13-week bills and for $4,901 million of 26-week bills, both to be issued on January 7, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 8, 1982			:	26-week bills maturing July 8, 1982		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	97.072 a/	11.583%	12.10%	:	93.828	12.208%	13.19%
Low	97.043	11.698%	12.22%	:	93.777	12.309%	13.31%
Average	97.053	11.658%	12.18%	:	93.791	12.282% 2/	13.28%

a/ Excepting 1 tender of $700,000.

Tenders at the low price for the 13-week bills were allotted 61%.
Tenders at the low price for the 26-week bills were allotted 96%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 51,645	$ 39,245	:	$ 83,435	$ 42,435
New York	8,424,335	3,854,220	:	8,121,555	3,903,465
Philadelphia	89,240	39,240	:	17,520	17,520
Cleveland	63,770	50,705	:	54,665	44,665
Richmond	47,870	47,870	:	69,770	51,770
Atlanta	54,855	53,095	:	42,420	34,960
Chicago	859,745	265,495	:	883,455	256,455
St. Louis	33,650	32,650	:	32,630	28,630
Minneapolis	20,380	17,380	:	18,455	9,455
Kansas City	50,975	50,060	:	59,780	53,030
Dallas	25,385	25,385	:	16,100	16,100
San Francisco	558,800	159,900	:	836,135	213,935
Treasury	265,030	265,030	:	228,495	228,495
TOTALS	$10,545,680	$4,900,275	:	$10,464,415	$4,900,915
Type					
Competitive	$ 8,568,735	$3,023,330	:	$ 8,124,910	$2,661,410
Noncompetitive	1,013,785	1,013,785	:	766,905	766,905
Subtotal, Public	$ 9,582,520	$4,037,115	:	$ 8,891,815	$3,428,315
Federal Reserve	875,960	775,960	:	850,000	750,000
Foreign Official Institutions	87,200	87,200	:	722,600	722,600
TOTALS	$10,545,680	$4,900,275	:	$10,464,415	$4,900,915

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.040%.

R-555

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

January 5, 1982

BIOGRAPHICAL NOTES

R. T. McNAMAR
DEPUTY SECRETARY OF THE TREASURY

R. T. McNamar, 41, was nominated to be the Deputy Secretary of the Treasury by President Ronald Reagan on January 23, 1981. At 41 years of age, he is the youngest Deputy Secretary in Treasury's history. He brings to Treasury a wide range of experience gained from executive positions in both private industry and government.

Before joining the Reagan Administration, he was Executive Vice President of the Beneficial Standard Corporation, a diversified financial services holding company in Los Angeles.

Prior to joining Beneficial Standard, Mr. McNamar served as Executive Director of the Federal Trade Commission from November 1973 to March 1977, during which time he handled a wide variety of energy, antitrust, and financial reporting policy issues, as well as introducing program evaluation concepts into the Commission and developing its first program budget.

During Phase II of the Economic Stabilization Program, he was Director of the Office of Case Management and Analysis for the Pay Board. He also served as internal management consultant to the Cost of Living Council, White House and Federal Energy Office.

From October 1966 until January 1972, Mr. McNamar worked as a management consultant with McKinsey & Company, Inc., in San Francisco, New York and Amsterdam and as a legal and financial counselor for Standard Oil Company of California from September 1965 to October 1966.

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A member of the California and American Bar Associations and the Financial Executive Institute, Mr. McNamar has authored several magazine and newspaper articles and has contributed chapters to two books.

He was born April 21, 1939, in Olney, Illinois, and was raised in Tulsa, Oklahoma. He received an A.B. degree from Villanova University in 1961, a J.D. degree from the University of Michigan Law School in 1963, and an M.B.A. degree from the Amos Tuck School of Business Administration at Dartmouth College in 1965.

He is married to the former Mary Ann Lyons. They have two children: a boy, Brendan, 13, and a girl, Lindsay, 11.

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TREASURY NEWS
epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. January 5, 1982

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 9,800 million, to be issued January 14, 1982. This offering will provide $ 1,200 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $8,599 million, including $ 1,309 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $ 1,965 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 $ 4,900 million, representing an additional amount of bills dated October 15, 1981, and to mature April 15, 1982 (CUSIP No. 912794 AM 6), currently outstanding in the amount of $ 4,549 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $ 4,900 million, representing an additional amount of bills dated July 16, 1981, and to mature July 15, 1982 (CUSIP No. 912794 AW 4), currently outstanding in the amount of $ 4,011 million, the additional and original bills to be freely interchangeable.

Both series of bills will be issued for cash and in exchange for Treasury bills maturing January 14, 1982. Tenders from Federal Reserve Banks for themselves and as agents for 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 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. 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.

R-557

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, January 11, 1982. 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 as of 12:30 p.m. Eastern time on the day of 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 January 14, 1982, in cash or other immediately-available funds or in Treasury bills maturing January 14, 1982. 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 Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of. Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AFTER
7 P.M., Wed., Jan. 6, 1982

CONTACT: Stephen Hayes
(202)566-2041

TREASURY DEPUTY SECRETARY CALLS FOR MORE INTERNATIONAL CO-FINANCING

In addressing the Executive Board meeting of the Banker's Association of Foreign Trade, Deputy Treasury Secretary R.T. McNamar today applauded the World Bank for significantly increasing the number of loans which are co-financed by the Bank and private lending institutions.

Mr. McNamar said that within one or two years, as much as half of the World Bank loans could involve private co-financing and that this ratio could grow to two out of three within five years.

"Given the limited resources of government contributions to the World Bank, greater use of co-financing can significantly increase the total amount of funds targeted toward development in the Third World," he said.

The World Bank is already moving in this direction, said Mr. McNamar. In 1976 only five of 73 World Bank loans were co-financed with private institutions and accounted for $272 million from the private sector. Last year 18 of 79 loans involved co-financing and accounted for $1.7 billion from the private sector.

"To date 36 U.S. commercial banks have been involved in World Bank co-financing projects. This is nearly one-third of all banks worldwide that have participated, but the total must be substantially increased," Mr. McNamar said.

"A minority (27) of Bank Association members have participated. I would like to see this minority become a majority by the end of this Administration."

McNamar said that "in order to expand private co-financing the co-financing package may have to be made more attractive."

"Any or all of the following may prove necessary," he said.

R-558

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE January 6, 1982

RESULTS OF AUCTION OF 7-YEAR NOTES

The Department of the Treasury has accepted $3,250 million of $6,081 million of tenders received from the public for the 7-year notes, Series C-1989, auctioned today. The notes will be issued January 13, 1982, and mature January 15, 1989.

The interest coupon rate on the notes will be 14-5/8%. The range of accepted competitive bids, and the corresponding prices at the 14-5/8% coupon rate are as follows:

	Bids	Prices
Lowest yield	14.65%	99.887
Highest yield	14.84%	99.077
Average yield	14.74%	99.502

Tenders at the high yield were allotted 78%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 17,602	$ 8,602
New York	5,328,491	2,876,771
Philadelphia	15,530	14,530
Cleveland	18,352	18,352
Richmond	39,433	38,433
Atlanta	17,792	17,792
Chicago	450,943	140,283
St. Louis	17,343	17,343
Minneapolis	25,834	25,834
Kansas City	32,955	32,955
Dallas	14,321	14,321
San Francisco	101,159	44,159
Treasury	1,030	1,030
Totals	$ 6,080,785	$3,250,405

The $3,250 million of accepted tenders includes $414 million of noncompetitive tenders and $2,836 million of competitive tenders from private investors.

In addition to the $3,250 million of tenders accepted in the auction process, $250 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

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TREASURY NEWS
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REMARKS BY

R. T. McNAMAR

DEPUTY SECRETARY OF THE TREASURY

THE FUTURE ROLE OF THE WORLD BANK GROUP

BROOKINGS INSTITUTION

WASHINGTON, D.C.

JANUARY 7, 1982

INTRODUCTION

-- Thank you for the opportunity to participate in this conference on the future role of the World Bank Group.

-- The World Bank Group is an integral component in the Reagan Administration's overall approach to international economic development. However, the Bank will be severely tested in the near future to adapt its operations to the new economic realities both in capital markets and its Part One countries.

-- The Bank has already demonstrated its flexibility in adapting its program to different recipient needs from 1946 until today.

- o During the 1945-1960 period, the Bank's efforts were focused on post-war reconstruction, with development emphasis picking up sharply later in the period;

- o 1960-1970 saw the emergence of the "Third World" and the Bank's efforts were exclusively in developing countries and largely in infrastructure projects; IDA was founded during this period.

- o Despite major international economic disruptions, the period 1970-1980 saw a growth and reorientation of multilateral aid toward aiding the rural poor; the 1974 and 1979 oil-shocks moved the private banking sector into a major role as the providers of developing country external finance, while official finance became increasingly constrained toward the end of this period.

-- As for the 1980's, where do we go from here? I would like to share some of our thoughts with you today.

THE MODERN DEVELOPMENT DILEMMA

-- From an economic perspective there are some important facts that influence the United States view of the economic development process:

o For oil importing developing countries domestic capital still provides the bedrock for most economic growth: foreign capital finances only one-seventh of their total investment;

o Official development aid provides only about four percent of all external capital flows of non-oil developing countries;

o Gross exports are the largest source of external capital providing about 83 percent of the total.

-- These figures show that to focus solely on official development aid, as occurs in many discussions of development, is analytically inadequate.

-- Aid is important for many of the poorest countries with limited exports and little access to funds on commercial terms. However, resisting protectionism and ensuring access to markets is of far more importance for the developing countries as a group. These issues should receive much more prominence in the consideration of economic development.

-- In external capital flows, the U.S. is an important partner in the developing countries' economic growth process. On the export side:

o The United States is the largest market for LDC exports. In 1979, for example, the United States obtained a larger share (23 percent) of its imports from non-oil developing countries than any other industrialized country.

o The U.S. market buys over 50 percent of all non-OPEC developing country exports of manufactured goods to developed countries.

- o To put the importance of the U.S. market in perspective, all developing countries' earnings from exports to the United States are double the amount of foreign aid from the industrialized countries.

- o A strong U.S. economy means growing export markets for LDCs. Therefore, the greatest contribution the United States can make to developing countries is to have sustained non-inflationary growth in its own economy.

-- With respect to financial flows:

- o U.S. banks are important intermediaries for financial resources, with approximately 40 percent of developing country loans from commercial banks being owed to U.S. banks or their branches and affiliates.

- o Another way non-inflationary growth in the United States helps the developing world is in its impact on interest rates and debt service. Because much of the debt owed by developing countries is at floating rates, each one percentage point decline in interest rates will result in about a $1 billion reduction in developing country debt service.

  - * The immediate benefits of a 6 point drop in interest rates would be virtually equal to U.S. ODA.

  - * In fact, the fall in LIBOR to date from last spring's high rate of around 19-1/2 percent has eased developing country debt service by $5 billion ... or approximately two-thirds of recent U.S. ODA.

- o Finally, the U.S. remains the largest contributor of official development assistance.

-- Funds derived from export earnings and from reduced debt service help to avoid what can be called the development dilemma -- the existing paradox in aid programs.

-- Increased aid increases developed country budget deficits at a time when their deficits are already considered to be too large. Similarly, measures to increase liquidity such as SDR allocations increase international liquidity at a time liquidity is already excessive. The tendency has been to monetize these larger deficits, which along with this increased SDR liquidity, increases inflation and therefore interest rates. The higher interest rates increase the debt service burden on the LDCs and so on.

-- The result is to worsen conditions in developing country export markets. In effect, at some point the short-term "fix" may be self-defeating in the long run.

-- Of course, the contribution of sustained non-inflationary growth in the United States also allows us to provide security assistance and a military umbrella ensuring the peace and stability which is necessary environment to provide development. Indeed, those who criticize the United States for our "low" contribution to ODA should recognize the security umbrella we provide for development.

-- To those who suggest the United States has been "disgraceful" in its support of the multilateral institutions, I point out two facts:

  o If our aid has dropped 90 percent from the high water mark of the Marshall Plan days, our GNP as a part of the world GNP has dropped from 42 percent in 1950 to 21 percent in 1980.

  o And, the U.S. was the strongest supporter of the World Bank and IMF at the recent Cancun Summit.

  o Reagan Administration is second to none in its support of MDBs.

-- In order to address the current development dilemma, then, the United States must achieve sustained non-inflationary growth which in turn can provide increased export earnings and reduced debt service for the developing countries.

THE DEVELOPMENT CAPITAL CONTINUUM

-- In view of these statistical realities, a major focus of development policy must be the generation of non-aid capital flows. Within this context, there is a development capital continuum in which it is useful to view the World Bank and the development effort.

  - The poorest developing countries receive the most concessional aid through IDA, for example, with little non-concessional financing.

  - As they reach progressive stages of "maturation", they become blend countries receiving IBRD financing.

  - Co-financing with private sources gradually becomes a greater component of their external flows. Such co-financing can occur with the development banks regular lending as well as with the International Finance Corporation (IFC).

  - Finally, at the graduation stage, official lending which by then is a very small component ceases entirely. Indeed, such countries can become providers of capital for the development efforts of others.

-- In our view, World Bank Group lending should be seen in this continuum and judged against its ability to assist borrowers in moving through it.

Concessional Assistance

-- Everyone must recognize the political environment in which we operate, the limited prospects for new or expanded aid initiatives, and the Congressional difficulties involved in keeping aid at current levels.

-- In this context, we consider Congressional authorization of IDA VI at the negotiated levels a major victory for the Reagan Administration. (Indeed, we have also gotten the Congress to pass the first Foreign Assistance Appropriations since 1978.)

-- We eagerly await the specifics on the promised Bank initiative regarding repackaging IDA.

-- In considering a possible next IDA proposal, the new criteria must be economically sound, giving recognition to the economic and other factors previously mentioned. The new proposal must be responsive to criticisms or critics, or refute them with convincing analysis: not hollow rhetoric.

-- The key issues which must be faced in any proposed IDA are:

  o Length of maturities, including possible acceleration of repayment schedules;

  o Fees and rates charged;

  o Conditionality; and

  o Relationship to blend lending.

-- We cannot expect larger and larger replenishments for concessional financing. The political and economic realities will not permit it.

-- The Reagan Administration will not make popular, convenient commitments that we know we can't get through the Congress. And we won't make commitments our successors will find difficult or impossible to get through the Congress. Although it is appealing in the short term, it would be disingenuous to create false expectations.

The Blend Countries

-- The maturation of the blend countries solely into the IBRD solely must be pursued susbstantially and consistently. "Traditional" treatment of particular countries must be re-thought in light of current realities -- e.g., if a country can devote scarce resources to wasteful domestic programs, can it really be viewed as a major contender for concessional lending?

Hard Lending

-- With regard to IBRD hard lending, I might briefly mention our pleasure that the General Capital Increase (GCI) authorization legislation has been signed by the President, as has the appropriation for the first U.S. subscription of $109.7 million in paid-in capital and the accompanying callable capital.

-- We would like to see all blend countries that are in satisfactory balance of payment positions to be moved rapidly into only Bank lending.

-- With this greater dependence upon the IBRD, however, I must note with concern the Bank's past practice of making fixed rate commitments.

-- We await with interest the coming Bank analysis of floating rates and variable terms, which have become common in other financial institutions.

-- We would like to emphasize, however, the importance of thoroughly analyzing and understanding the problem. We don't want a solution in the energy affiliate mode. Bluntly put, this was an area that the private sector can and will adequately serve. The energy affiliate would have simply substituted less expensive public development capital for available private capital. Indeed, the Bank is meeting the challenge through expanded energy lending, within its budgetary limitations, which we support.

-- In considering new lending initiatives, the Bank should give greater weight to the appropriate policy response by recipients and the catalytic effect on non-Bank resource flows.

Co-Financing

MDBs

-- This brings me to a most important and potentially large segment of the continuum: private co-financing with the multilateral development banks.

-- This role of catalyzing private financial flows is specifically stated in Article I of the World Bank's charter.

- o Article I calls for the Bank:

  "To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors."

-- The view that the MDBs must become more active financial catalysts for private capital flows in the years ahead is shared by Tom Clausen who stated in his inaugural speech to the Fund/Bank meetings last Fall that:

  "The private sector particularly represents an immense potential source of investment capital...(and) we will seek to increase substantially the level of private co-financing in the next several years."

-- Substantial progress to involve the private commercial banks in the activities of the MDBs began under Bob McNamara's presiding and is continuing.

- o The MDBs have instituted active programs to involve commercial banks in greater co-financing.

- o In 1976 the World Bank could count only five projects out of seventy-three which were co-financed with private as opposed to public institutions, accounting for $272 million from the private sector.

- o In 1981, 18 of 79 co-financed projects involved commercial banks with the amount of private co-financing reaching $1.7 billion.

- o By way of perspective, this $1.7 billion exceeded the total lending of the Asian Development Bank and came close to matching the lending volume of the Inter-American Development Bank in their most recent fiscal years.

-- In other words, right now private co-financing is a major and growing source of development assistance. We applaud this trend and hope to see it continue.

The Future of Private Co-Financing

-- What can we expect in the future? Given the compelling logic and budgetary pressures toward growth of private co-financing, it seems almost inevitable that this activity will expand rapidly.

- o In 1980 private co-financing was involved in 21 of the Bank's 140 development projects financed during that year, amounting to about 15 percent of the projects and 20 cents of every dollar lent.

- o The World Bank hopes to see the number of private co-financing operations reach 50 per year in the next one or two years or nearly one project in three.

- o The Bank also believes it is realistic to think in terms of a ratio as high as two out of three projects involving private sector co-financing in five years time.

-- This expansion is not inevitable, however. Wanting it to happen won't make it happen. At least three things should take place if we are actually to fulfill the potential that is there.

- o Co-financing must be more actively marketed by the MDBs.

- o The co-financing package must be made more attractive to the private banks.

- o Regulatory concerns must be addressed.

Co-Financing Must Be More Actively Marketed

- o This must primarily be a responsibility of the multilateral development banks' management.

- o The number of commercial banks involved in this activity must be expanded.

  * To date, 36 U.S. commercial banks have participated in World Bank co-financed projects. This is nearly one-third of all banks worldwide that have participated, but the total must be substantially increased.

The Co-Financing Package

-- In order to expand private co-financing the co-financing package may have to be made more attractive. Any or all of the following may prove necessary:

- o Project information will need to be shared throughout the life of the project not just in the beginning.

- o MDB/borrower dialogue must include co-financing as a priority item.

- o For example, why shouldn't those countries approaching the IBRD graduation threshold be expected to have an increasingly larger percentage of their borrowings represented by co-financing?

    - * The World Bank will shortly issue a Board paper on revisions in its graduation policy.

    - * We hope the Bank will strongly consider making the role of co-financing more explicit in its delineation of graduation and maturation stages.

- o The cross default clause may have to be made mandatory. Perhaps some of you will share your thoughts on this issue in the question and answer period.

- o New co-financing instruments and techniques may be necessary.

    - * The Bank is considering a scheme whereby certain new loans could contain two parts: an "A" loan funded exclusively by the IBRD, and a "B" loan normally funded by private lenders at market terms, but structured so it could include IBRD funds as well.

* The Bank is also considering taking a position in the B loan to provide added security and stretch maturities.

* And we also believe the International Finance Corporation (IFC) with its proven private sector track record can be helpful to the Bank in these efforts.

Regulatory Concern

-- Of course the existing bank regulatory environment is of considerable importance in this whole area of private co-financing.

-- You are all aware of the 10 percent of capital limit on a commercial bank's lending to a single borrower as stipulated by Federal Law 12 USC 84. How this 10 percent limit is interpreted by the Comptroller of the Currency has implications for the growth of co-financing.

  o I have just asked the new Comptroller of the Currency to re-examine the present interpretation when it comes to co-financed loans with a multilateral development bank.

  o Legislative change may also be appropriate and will be considered.

-- Foreign bank supervisory bodies also appear to be taking a new look at their treatment of co-financed loans.

-- In this regard the Bank of England has recently modified its views on MDB co-financed loans.

  o In the future the Bank of England will adopt the view that: "the inclusion of more co-financing loans in a bank's asset portfolio could well lead to a perception on the part of supervisors that the bank had lowered the overall risk element in its lending ... and such a development would influence their assessment of the extent to which the bank could prudently expand its lending further."

- o I would also note the recognition by the Amsterdam-Rotterdam Bank of a separate evaluation for loans co-financing with offical development institutions, wholly outside the country ceilings ordinarily used by the Bank.

  * The lesser credit risk through the increased security in respect to political uncertainties and the quality of projects was used to justify this action.

  * Those bankers who complain about the spreads on co-financed loans being too thin would do well to take a lesson from their Dutch colleagues, especially since it is very consistent with modern portfolio theory. In fact, we believe the financial markets do work, and since there is less risk on an MDB co-financed loan, the spreads may be appropriately smaller.

  * Moreover, if loans co-financed with the World Bank and other multilaterals are much less subject to rescheduling or default than other commercial bank loans, supervisory evaluations should reflect this. We intend to ask the relevant regulators in the United States to consider this action.

<u>The IFC</u>

-- Another important vehicle for co-financing is the World Bank's International Finance Corporation. Last year, for example, of the IFC's $180 million of equity and loan commitments, nearly half were backed through IFC syndications involving over fifty financial institutions.

-- In looking to the Bank to increase its catalytic role and leveraging its financial resources, I would like to raise the possibility of a larger relative role for the IFC. As some of you know, the United States has been talking with the IFC informally and has some ideas on the future directions it could move. Among these are:

- o The IFC should concentrate its activities more directly on those areas of its comparative advantage;

- o It should undertake projects where it has the greatest economic/development impact; and

- o It should seek ways to increase its type of financial activities either on its own or in concert with other international institutions.

-- There are four specific areas where IFC possesses substantial comparative advantage.

- o First, the development of capital markets, primarily through technical assistance, is an essential IFC activity which could be expanded.

- o The IFC has the singular capability to fashion impressive financing packages which result in tremendous financial leverage for a given IFC dollar.

- o Traditionally, its lending and equity programs have focused on private sector market-oriented industrial activity which should be viewed as an increased area of specialization.

- o The IFC is in a unique position to assist LDCs in developing more efficient industrial policies which are indispensable to stimulating private flows.

-- Finally, while it is too early to determine whether the IFC or the Bank will be the lead institution, I would like to at this point endorse in principle the investment insurance scheme mentioned by President Clausen. We look forward to seeing the specific proposal at a later time.

Graduation

-- Finally, our development continuum leads us, naturally, to graduation from the Bank. Greater movement of countries through the development continuum cycle must of necessity involve an increased graduation effort.

-- As private flows increase, whether through co-financing or other forms, our scarce aid resources should be focused increasingly on the most deserving. The winners in the competition for limited funds must be the poorest in income terms and those which promise -- and deliver -- the best performance.

-- In our view, there is no virtue in providing Bank funds to countries that do not need aid -- all present and future loans should be audited in this light.

-- Of course, the ultimate goal is for countries to become self-sufficient and independent so that they do not need external capital. Indeed, a number of early borrowers from the Bank have achieved that status.

CONCLUSION

-- As you know, our MDB policy assessment -- the basis for much of what I've said -- is nearly completed. We feel the assessment provides a sound analytical basis and justification for continued strong U.S. endorsement and support for all the MDBs, including the World Bank Group.

-- The Bank Group has been a critical means for effective policy reform in the developing world. In the future, it will increase its crucial role as a catalyst for private flows.

-- As the Bank changes, the U.S. will enthusiastically participate in its evolutionary process of building a consensus for new directions. It is important that the World Bank -- as well as other international financial institutions -- be protected against disruptive change which would shake the confidence of private investors. As President Reagan said at the last Bank/Fund Annual Meeting:

> "We strongly support the World Bank. And because of our strong support, we feel a special responsibility to provide constructive suggestions to make it more effective. We believe these suggestions will permit it to generate increased funds for development and to support the efforts developing countries are making to strengthen their economies."

-- Take the ideas I've presented today in that spirit. The Reagan Administration strongly supports the World Bank, and will continue to do so given the leadership and policy changes we can foresee in its future.

Thank you.

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Treasury Deputy Secretary McNamar

Addresses

Future Role of the World Bank

Deputy Treasury Secretary R.T. McNamar stated today that in the future the major focus of the World Bank's development policy must be the generation of non-aid capital flows.

In addressing a Brookings Institution Conference on the Future Role of the World Bank Group, Mr. McNamar said, "From an economic perspective there are some important facts that influence the United States view of the economic development process. For oil importing developing countries domestic capital still provides the bedrock for most economic growth: foreign capital finances only one-seventh of their total investment."

He added that, "The reality of the economic perspective with which we view development is that aid provides about 4 percent of external capital flows to non-oil lesser developed countries. Gross exports, providing about 83 percent, are the largest source of external capital."

Drawing on this perspective, Mr. McNamar described the "Development Capital Continuum" whereby the poorest countries receive the most concessional aid through the International Development Association (IDA).

"As these countries reach progressive stages of maturation, they become blend countries receiving private and World Bank financing," he said. "Co-financing with private sources gradually becomes larger until, at the graduation stage, official lending can cease entirely."

Strongly endorsing the World Bank as an institution, Mr. McNamar said that "World Bank Group lending should be seen in this continuum and judged against its ability to assist borrowers to move through it. In considering new lending initiatives, the World Bank should give greater weight to the appropriate policy response by recipients and the catalytic effects on non-bank resource flows."

"The co-financing opportunities of the International Finance Corporation, a part of the World Bank Group, can and should be expanded," said Mr. McNamar.

TREASURY NEWS

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FOR IMMEDIATE RELEASE
January 8, 1982

REMARKS PREPARED FOR DELIVERY BY
THE HONORABLE R.T. MCNAMAR
DEPUTY SECRETARY OF THE TREASURY
TO THE CALIFORNIA BANKERS ASSOCIATION
SANTA BARBARA, CALIFORNIA
FRIDAY, JANUARY 8, 1982

I have been looking forward to the opportunity to speak to you today. Thanks very much for inviting me.

I would like to talk about something on which we in the Treasury and the Administration have been spending a great deal of time--deregulation and competition in your industry.

Some of you may ask: "Why be concerned?" After all, the Depository Institutions Deregulation and Monetary Control Act of 1980 has been in effect for two years, and many of you have done very well in that period.

Nationwide, there are more banks operating now than on December 31, 1979, immediately before the DIDC Act was passed (12/31/79 14,357 banks; 6/30/81 14,463).

Commercial bank net income is up over 20 percent since 1979; the increase has been even larger for small banks, approaching 25 percent.

Income as a percent of equity and as a percent of total assets is down marginally since 1979, but up significantly over the past several years.

	All Banks		Smallest Banks (Assets less than $100 million)	
	1975	1981 (est.)	1975	1981 (est.)
Net income/equity	11.3%	14.0%	10.9%	15.6%
Net income/assets	.72%	.82%	.91%	1.36%

But before you are lulled into a false sense of security, let me review for you some longer term trends, and what we believe are some fundamental changes taking place in the market-place for financial services today.

R-562

Market share

Commercial bank market share is declining. There are a number of ways to measure market share; one which I find useful is the share of financial assets of households held by commercial banks. Your share of these assets has fallen, from nearly 35% in 1945 to 25% in 1977 to 22% today.

The rate of decline in recent years was paralleled only in the 1950's, and is particularly noteworthy because it represents a sharp break from the plateau at around 25% which had existed for the sixteen years between 1961 and 1976.

Phasing out of low-cost deposits

For years, banking laws have subsidized banks and S&L's (and, ultimately, their borrowers) at the expense of depositors and savers. Thus, as you all know, historically a major contributor to your profitability has been Regulation Q on your savings deposits and similar ceilings on your checking accounts. However, the size of this subsidy may not have been apparent to you.

I recently reviewed an internal study of a major consulting firm which estimated that the spread between the interest paid on these low-cost accounts and the earnings they provided commercial banks was about $30 billion last year--that's right, $30 billion. That $30 billion compares with an industrywide profit in 1980 of about $20 billion. Thus, if these low-cost deposits had disappeared in 1980 and commercial banks had been forced to pay rates which were high enough to eliminate the spread, an industrywide profit of $20 billion could have turned into an industrywide loss of $10 billion.

These low-cost deposits have, of course, not disappeared; however, their reduction over time is inevitable. The Depository Institutions Deregulation Committee--the DIDC--which the Secretary of the Treasury chairs--is under Congressional mandate to phase out rate ceilings by 1986.

Even if the DIDC does not act for some reason, or Congress changes its mind, consumers will effectively eliminate the accounts by pulling deposits out to invest in higher-yielding alternatives. Deposits in savings and loan accounts paying the "regular" rate or less fell by $15 billion--$1 billion a month--over the fifteen months from July 1980 to September 1981. "Regular rate" deposits fell another $2.5 billion in October, with the advent of the All-Savers Certificate. Assuming an effective spread on these low cost funds of 7%, which was the approximate spread in 1980, a $1 billion a month reduction represents a loss in annual profit contribution of $70 million for each month of the period. The cumulative loss in profits from this $15 billion drain alone now exceeds $1 billion annually.

Of course, this loss of low-cost deposits is not limited to savings and loans. Savings deposits in commercial banks fell from $191 billion in September 1980 to $158 billion in September 1981. This is a $33 billion decline, or $2.75 billion monthly.

Moreover, the overall structure of your liabilities has changed substantially. For example, demand deposits constituted 66% of your liabilities in 1960. In 1980, they represented only 30%, and, now that interest can be paid on checking accounts, that 30% was not necessarily cost free.

This change in your liabilities was mirrored in the change in the assets of others. Sight deposits as a percent of total deposits by the domestic nonfinancial sector were 42% in 1960, but only 16% in 1980.

Thus, loss of the subsidy provided by low-cost deposits is inevitable. Institutions will either pay more and retain these funds, or lose them to competing market rate instruments and institutions.

Technology

Changes in technology are making banking as we know it obsolete. You are all familiar with ATM's and cash dispensers in airports; some of you may intend to participate in the new national ATM systems to be introduced this year. Many of you may consider ATM's the wave of the future; in truth, with 25,000 already installed nationwide, they are the "wave of the present".

Indeed, your younger and future customers, the young adults and children of today, probably consider these developments old hat. They have grown up with computers and accept them as a natural part of their world as much as we did the telephone. My son, who is 13, is busy developing applications for his home computer; the five-year old daughter of one of my associates is learning math and spelling from hand-held machines. I am sure many of your own children are doing the same. For them, the old maxim "don't trust anyone over thirty" may take on a new meaning: they will not trust us because we have become technically incompetent and technologically obsolete.

In the future, thanks to cable television, satellites, and the telephone, the consumer will not even have to go to the bank, to an airport or to an ATM. He will do his banking from his home or place of business. Indeed, not just his banking, but all of his financial business, including stocks, bonds and insurance.

And this is not the distant future: Touch-tone billpayer services are already with us, and I recently read of a Midwest grocery store which directly debits customers' checking accounts from the check-out line. A Warner Communications-American Express joint venture already offers an interactive "two-way" cable system, and this subsidiary was awarded franchises covering more than two-thirds of the homes for which franchises were offered in 1980. One communications industry consultant has predicted that some form of in-home banking will be available to a fifth of American households in the next five years.

Indeed, as I was putting these remarks together, I realized that I had been within the four walls of my bank only twice in 1981, and one of those times was to use the ATM in the lobby because the ATM on the street was being serviced. My point is this: the old days of brick-and-mortar banking are over--for lending, for financial services, and even for that one function which has distinguished depository institutions from all others--taking deposits.

Financial supermarkets

A journalist recently compared the state of banking today with the grocery business of the 1920's and 1930's. Fifty years ago, butchers sold meat, green grocers sold produce, drugstores sold medicines, and other shops sold sundries. The advent of the supermarket put many of these single-service shops out of business, and substantially changed the way the remainder conducted their operations.

A recent private study found perhaps an interesting parallel. The average consumer uses over 30 financial services per year, and goes to more than a dozen financial institutions to obtain them. We are witnessing today a change in this environment, and the emergence of supermarkets in the financial services industry. I am not predicting the demise of specialized financial institutions; financial services are not cabbages, and the customer's need for specialized, individual assistance for his financial affairs will remain. A market for specialized institutions will exist. However, banks and other depository institutions that wish to specialize should do so by choice; they should not specialize because they are required to do so by government regulation.

Many of you are undoubtedly aware of who your competitors are, and of the range of services they offer, but let me review them briefly.

Your competitors--the money center banks--offer credit cards, check cashing, consumer finance and travel planning nationwide, loans in most states and mortgages in some locations.

Your competitor Manufacturers Hanover of New York recently bought a string of 67 finance offices in California, Oregon and Washington.

Your competitor Merrill Lynch offers mortgages, check-writing, trust and estate planning and money management.

Four of your competitors--savings and loans, including one here in California--are seeking to operate a securities brokerage subsidiary and to offer investment advice and portfolio analysis. An additional 150 to 200 S&L's have indicated an active interest in becoming associated with this subsidiary.

Two of your competitors--both banks--have already taken similar steps. And these are just the "regulated" institutions.

Your "unregulated" competitors have greater flexibility. Your competitor Sears has long offered insurance and consumer credit. It has recently acquired the nation's fourth largest brokerage firm, decided to establish a money market fund, and purchased the nation's largest real estate brokerage firm. It is also the largest savings and loan holding company in the United States.

Your competitor American Express offers credit cards, cable television, securities brokerage, traveller's checks and travel planning (as well as airport cash).

Your competitor General Electric is involved in real estate loans, second mortgages, commercial real estate financing, mortgage insurance and leveraged leasing.

Your competitor National Steel--yes, National Steel--owns three savings and loans.

Your competitor Baldwin-United, formerly best known for its pianos, has also acquired a savings and loan. You are even competing with the funeral directors of the state of New Jersey, who will put your deposit into a fund which covers funeral expenses and also pays money market rates of interest.

An important characteristic of many of these financial supermarkets is that they operate nationwide. Sears has 800 department stores and 283 Dean Witter offices. American Express has 1100 offices plus 246 Shearson offices. General Electric has 300 branches. Merrill Lynch has 442 offices. The issue of "interstate banking" seems pale in comparison with numbers of this magnitude. Indeed, to speak in domestic terms alone may be too limiting. For example, six of the ten largest banks in California have their home offices in foreign countries.

Of course, implicit in all these "supermarket" strategies is the recognition of the convenience of one-stop shopping and the importance of customer contact. I will leave it to you to judge how difficult it will be to get your existing customers back once they are lured away.

<u>What we (the Administration) propose to do</u>.

I would like to talk now about what we (the Administration) propose to do about all this. We start with the perspective that the market has already changed, and that the regulators, and rest of the government, including us, are 10 years behind. We are simultaneously trying to catch up <u>and</u> to get out of the way; indeed, you might say that we are trying to catch up <u>by</u> getting out of the way.

Secondly, we start with the recognition that change is inevitable. Financial supermarkets are coming, as are higher-cost deposits, new financial services, and some form of in-home banking. Thus, the issue of deregulation is not whether new financial services and new competition for banks and S&L's will exist; the issue is whether depository institutions will be able to compete with other institutions already offering these services

We have therefore proposed a "level playing field" for all competitors. Depository institutions and non-banks alike should be allowed to play the same game on the same field. Thus, you should have the opportunity to underwrite revenue bonds and to offer money-market mutual funds and other services traditionally barred to deposit-taking institutions. Conversely, securities firms ought to have the right to get into the banking business.

However, not only the game should be the same; the rules should be the same. Thus, in exchange for the ability to offer new services, savings and loans should no longer be guaranteed that banks will pay less for deposits--the differential between the rates S&L's and commercial banks can pay for passbook and similar deposits should be eliminated.

Similarly, we have proposed that commercial banks engage in their new activities through affiliates of bank holding companies, such as an affiliate for securities activities. There would be one exception to this for small banks. Banks with assets of less than $100 million could conduct these activities through a separate subsidiary of the bank itself without incurring the burden of establishing a separate bank holding company structure.

Conducting securities operations through an affiliate would ensure that these operations are subject to the same taxation and laws--e.g., Securities and Exchange Commission regulations--as existing securities firms. Securities companies wishing to enter banking could establish a holding company and own a commercial bank within that company which would be subject to the rules of bank regulators. This approach would also protect depositors from the higher risks associated with non-bank activities.

Before I move on, let me emphasize the significance of the affiliate concept. Indeed, it is the most important part of the Administration's position. We want to give you these additional powers but we will not give you the competitive advantage-- the unfair competitive advantage--of exercising them directly. Banks' competitive position would be particularly unfair in the revenue bond market, which is the logical first step for expanded securities powers.

This favorable competitive position arises through two legal advantages--the ability to use funds from deposits paying a low controlled rate of interest, or no interest at all, to carry securities inventories, and the ability to deduct for tax purposes the interest expense of carrying these securities. Together these provisions give a profit advantage to banks of perhaps 15 to 30 percent. While these advantages may diminish somewhat as banks continue to rely more on purchased funds, under present law they would never be eliminated entirely. Ultimately these advantages would permit banks to dominate the market, not through competitive ability but as a result of government fiat.

Returning to our proposals, we also favor the concept of giving depository institutions the power to make direct investments in real estate equity, again through a bank holding company affiliate. We have endorsed a Federal preemption of state laws prohibiting due-on-sale clauses in mortgages offered by Federally-chartered depository institutions and certain institutions participating in mortgage insurance programs under the National Housing Act. We are also seeking the elimination of ceilings on rates depository institutions can charge for their loans, through a preemption of state usury ceilings.

While neither the Administration proposal nor the Garn Bill address interindustry or interstate issues, I would like to note with approval the recent change in policy by the Federal Reserve Board and FDIC to permit commercial bank acquisition of ailing thrift institutions.

Finally, we are seeking to extend the level playing field abroad. Our objective is to obtain national treatment for American banks operating overseas. U.S. banks should be able to compete in foreign markets on a basis of equality of opportunity with local banks. We understand some might be tempted to seek reciprocity as an objective. This is acceptable if reciprocity is defined as banks in two countries each receiving national treatment. In the traditional sense in which reciprocity is defined, we don't see it as a viable objective; banking rules do not easily lend themselves to reciprocity since national goals and characteristics differ. The important consideration is whether the Central Banks and financial authorities in foreign countries are trying to be fair and even-handed in their treatment of U.S. banks.

I personally think that we should shortly consider international lending by S&L's as well.

<u>What we know so far</u>.

Although deregulation is only in its initial stages, we have already learned some important lessons. The first is that depository institutions can compete if given the opportunity.

Much has been made of the rapid growth of money market funds, and indeed they represent a significant new factor in the financial environment. Assets of money market funds grew by $91 billion in the period from January 1980 to August 1981 (from $53 billion to $144 billion). The interesting point to note, though, is the increase in deposits in money market certificates offered by commercial banks, S&L's and mutual savings banks in the same period. They grew by over twice the amount money market funds grew --$200 billion--(from $291 billion to $491 billion).

The second lesson is that the market will respond. It was no accident that there was a continual outflow of funds from 2-1/2 year small savers certificates until the 12% cap was removed; it was also no accident that when the cap was removed deposits in these instruments at all depository institutions grew by almost $55 billion. Investors seek the best available yields, and the interest rate ceilings on the instruments offered by depository institutions have in general not been competitive. When rates are competitive, investors respond.

The third lesson is that institutions, like regulators, can be blind to the new environment. My favorite example is in a letter we received recently: A customer of a California financial institution (an institution not represented here, so far as I know) wrote us to say that he wanted to do his part to help others get access to loan money. He had gone to his local institution and offered to pay off his 6% mortgage.

The institution responded by telling him they would let him do so--but only if he paid a six-month prepayment penalty.

Needless to say, this customer is now less than sympathetic when certain financial institutions plead that they have been victimized by circumstances beyond their control.

A more important example of institutional blindness involves the new IRA-Keogh accounts. As you know, the IRA and Keogh provisions in the Economic Recovery Tax Act of 1981 represent one of the most significant new incentives for individual savings in decades. An estimated 48 million additional taxpayers will be able to deduct up to $2,000 per year in pre-tax income.

These provisions also offer an excellent opportunity for testing deregulation--a controlled experiment in which the size of individual investments is limited, depository institutions already account for a significant share of the market, and the maturity of the proposed instrument is less likely to cause withdrawals from passbook savings accounts. But, much of the mail we received from depository institutions on IRA/Keogh and virtually all the mail we received from their Congressional representatives asked us to delay introducing a new instrument to compete for these funds. Had the new instrument been delayed, the result would have been that the initial IRA/Keogh market would have been captured by insurance companies, securities firms and money managers. Again, I leave it to you to determine how difficult it would have been to recapture your customers once they had opened IRA/Keogh accounts with these competing institutions.

The point of this third lesson is that you have responsibilities to ensure that your institutions and staffs realize that the era of "business as usual" is over and that they are alert to the changes in the external environment. You should also ensure that your industry representatives do not play the role of Chicken Little, yelling "The sky is falling; the sky is falling" at every relaxation in the regulatory structure. Some enlightened industry leadership is called for; otherwise, regulated institutions will end up like Chicken Little, gobbled up by the fox, in this case your non-bank competitors.

<u>What you can do</u>.

I have spoken above about what we, the Administration, propose to do about the changing financial environment. I have also alluded briefly to what you can do, and would like to elaborate briefly on that. At least two types of responses are needed from you, a managerial response and a legislative response.

As managers, you will have to adjust to a world where you will pay more for your resources. You will have to develop new ways to attract assets, and you will have to redeploy assets. You will have to consider whether, as some suggest, you are trapped in a "branch-building" mentality, when your assets might be more profitably used in designing new products. You will have to develop new services.

As citizens and as affected parties, you must also get behind the effort to pass a deregulation bill.

The range of alternatives with which legislation is possible is now rather clearly defined. Only a few issues are really divisive and stand in the way of significant steps toward successful deregulation. We are convinced that the Administration's proposals represent the most realistic compromise among competing interests.

First, there is the issue of the expanded securities underwriting powers for commercial banks that I discussed earlier. Banks would like to have these powers within the bank because, among other reasons, of the competitive advantages this would afford them. Securities firms oppose expansion of these powers, particularly this form of expansion, also for competitive reasons. The Administration's proposal, besides being right in principle, offers the basis for compromise among these views.

Two other significantly divisive issues--which are interlinked--are the expanded assets powers of thrifts and the pace of interest rate deregulation. Many banks want greater flexibility in pricing and structuring the instruments they can offer, and oppose expanded thrift powers for competitive reasons. Many S&L's resist deregulation of their liabilities, and elimination of the differential until they have similar flexibility in their asset powers. Passage of the Administration-supported proposals for expanded thrift powers should allow interest rate deregulation to proceed more smoothly and more rapidly.

In sum, what I am suggesting is that this is truly a case in which we must all find a way to hang together, or you will all surely hang separately. Any one of the major industry groups is probably in a position to block any proposal, including the Administration's. And that outcome has been the sad history of most attempts at reform since the Hunt Commission report a decade ago.

Compromise is the only real alternative. That compromise, however, should not be at the level of the lowest common denominator. Such would be the case if the short-term bailout embodied in the so-called regulators' bill had been enacted. That would relieve the fever for a while, while allowing the disease to rage unchecked.

The only alternative is a compromise among yourselves, the thrifts, and the securities industry on a bill that embodies true movement toward the level playing field, with all players using the same rules for the same game. Without these steps, there may be no legislation, and without legislation, all the regulated depository institutions will continue to be shackled while their competitors capture the field. You can accept your new competition, support the Administration's legislation and work for future earnings, or you can watch your deposit base, customer relationships and market share erode to the point you can no longer compete effectively. The choice is yours.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
Friday, January 8, 1982

Contact: Press Office
(202) 566-2041

TREASURY ESTABLISHES NEW TAX-EXEMPT POLICY

The Treasury Department announced today that without further guidance from Congress, the Internal Revenue Service will no longer revoke or deny tax-exempt status for religious, charitable, educational or scientific organizations on the grounds that they don't conform with certain fundamental public policies.

"In the past," said Deputy Treasury Secretary R. T. McNamar, "the IRS has revoked the tax exemptions of organizations which, did not adhere to certain fundamental national policies, such as those forbidding discrimination on the basis of race, even though this requirement is not explicitly stated in the Internal Revenue Code except in the case of social clubs."

"Whether or not the Treasury Department or this Administration agrees with the position of the IRS in particular cases is not the issue," McNamar stated. "The question is whether the IRS is required under the Code as enacted by Congress to decide -- as a condition to granting or continuing tax-exempt status -- whether private organizations conform with fundamental national policies. The Treasury Department has concluded that this kind of judgment -- which may mean life or death for certain organizations -- is fundamentally a question for Congress; and if the authority to make this judgment is given by Congress to an administrative agency it should be done in explicit terms and subject to specific guidelines."

As a consequence of this decision, the IRS will restore the tax exemption of certain organizations which had previously been revoked. In particular, the appeal of Bob Jones University, and the Goldsboro Schools, which are currently before the Supreme Court will be rendered moot.

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"In taking this action," McNamar stated, "we are attempting to protect the independence of all private tax-exempt organizations -- many of which may follow practices and adhere to principles with which we disagree. But before the government gets into the business of deciding which organizations are worthy of tax exemption and which are not, we want Congress to fully consider the implications of such a course."

The Treasury Department decision reflects the advice of the Department of Justice that the authority which the IRS previously had been asserting as its basis for revoking the tax exemptions in question is not supported by the language of the Internal Revenue Code or its legislative history. The Internal Revenue Code provides tax exemptions for "Corporations (or other organizations) organized and operated exclusively for religious, charitable, scientific ... or educational ... purposes ...." IRC Section 501(c)(3), 26 U.S.C. Section 501(c)(3). The Justice Department has advised that both the language of Section 501(c)(3) and the statute's legislative history provide no support for the statutory interpretation adopted by the Commissioner in 1970. Thus the IRS is without legislative authority to deny tax-exempt status to otherwise eligible organizations on the grounds that their policies or practices do not conform to notions of national public policy.

This new policy is reflected in a motion filed with the Supreme Court today by the Justice Department to vacate a case in which the Internal Revenue Service revoked the tax-exempt status of Bob Jones University and Goldsboro Christian Schools. IRS revoked the Bob Jones University tax exemption in 1970 on the grounds that the school's racial policies violated Federal policies on racial discrimination. This decision was nullified by the U.S. District Court in South Carolina on June 30, 1971. However, the lower court's decision was reversed by the 4th Circuit Court of Appeals on December 30, 1980.

Similarly in 1974 the IRS determined that Goldsboro Christian Schools Inc. did not qualify for an exemption on the grounds that it maintained a racially discriminatory admissions policy. On May 7, 1980 the District Court for the Eastern district of North Carolina upheld the IRS decision. On February 24, 1981 the Court of Appeals for the 4th Circuit affirmed this judgement period.

Both schools appealed the Circuit Court decision to the Supreme Court which accepted their petitions for certiorari on October 13, 1981.

Goldsboro Christian Schools, Inc.

Chronology of Events

1. Goldsboro Christian Schools, Inc. ("Goldsboro") is a nonprofit organization incorporated in 1963; however, Goldsboro has never been granted tax-exempt status.

2. On July 10, 1970, the Internal Revenue Service announced that it would no longer recognize the tax-exempt status of private schools maintaining racially discriminatory admissions policies.

3. After audit in 1974, the Commissioner of Internal Revenue determined that Goldsboro did not qualify for exemption from federal unemployment and social security taxes and accordingly assessed those taxes against Goldsboro.

4. Goldsboro commenced a suit for refund of its partial payment of such taxes and the Government counter-claimed for the balance of the taxes assessed.

5. On May 7, 1980, the District Court for the Eastern District of North Carolina rendered judgment for the Government that Goldsboro's exemption was properly denied.

6. On February 24, 1981, the Court of Appeals for the Fourth Circuit in a 2-1 decision affirmed the judgment for the Government.

7. Goldsboro filed its petition for certiorari with the Supreme Court on July 2, 1981. The petition was granted October 13, 1981.

8. The parties briefs were set for filing on December 31, 1981.

January 8, 1982

Bob Jones University Case
Chronology of Events

1. Until 1970, the Internal Revenue Service recognized Bob Jones University ("BJU") as a tax-exempt organization described in section 501(c)(3) of the Internal Revenue Code.

2. On November 30, 1970, the Internal Revenue Service notified BJU and other private schools that it would no longer recognize organizations as legally entitled to tax-exemption which maintained a racially discriminatory admissions policy.

3. BJU responded that it did not admit black students and that it did not intend to alter that policy in September of 1971.

4. BJU filed suit to enjoin revocation on September 9, 1971. In 1974, the Supreme Court ruled that such a suit was barred by the Anti-Injunction Act and the Declaratory Judgment Act.

5. The Internal Revenue Service began a formal audit/ examination to determine payroll tax liability and to consider revocation of BJU's tax exemption during July, 1974.

6. In January, 1976, the Internal Revenue Service issued a final notice of revocation to BJU in January, 1976, effective from December 1, 1970.

7. On May 4, 1976 , BJU filed suit in federal district court in South Carolina seeking a refund of $21 in federal unemployment tax as a means of seeking reinstatement of it exemption. The United States counterclaimed for approximately $490,000 in federal unemployment taxes for the years 1971 through 1975.

8. The District Court held BJU qualified for tax exemption on December 26, 1978 and entered judgment for BJU in the refund suit. In a separate suit decided the same date, the District Court ordered the Secretary of the Treasury and Commissioner of Internal Revenue Service to restore BJU tax exempt status.

9. The Court of Appeals for the Fourth Circuit reversed both judgments in 2-1 decision and held that BJU was not entitled to tax exemption and entered judgment for the Government on December 30, 1980.

10. BJU filed a petition for a writ of certiorari to the Supreme Court on July 1, 1981. The petition for a writ was granted October 13, 1981.

11. The parties briefs were set for filing on December 31, 1981.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE January 11, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $4,900 million of 13-week bills and for $ 4,901 million of 26-week bills, both to be issued on January 14, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 15, 1982			26-week bills maturing July 15, 1982		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	96.961	12.022%	12.57%	93.543 a/	12.772%	13.84%
Low	96.927	12.157%	12.72%	93.514	12.829%	13.91%
Average	96.936	12.121%	12.68%	93.526	12.806% 2/	13.88%

a/ Excepting 1 tender of $800,000.

Tenders at the low price for the 13-week bills were allotted 65%.
Tenders at the low price for the 26-week bills were allotted 48%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 77,430	$ 63,415	$ 97,705	$ 51,705
New York	9,455,640	3,821,555	8,496,185	3,827,790
Philadelphia	46,840	46,340	24,735	24,735
Cleveland	59,260	51,260	94,750	54,750
Richmond	84,360	58,360	109,225	61,625
Atlanta	74,740	72,125	58,430	49,455
Chicago	743,695	241,470	673,100	81,700
St. Louis	49,110	34,310	50,925	30,275
Minneapolis	10,390	10,390	12,150	12,120
Kansas City	60,520	58,575	59,030	55,055
Dallas	28,840	28,840	28,035	18,035
San Francisco	541,825	143,825	869,655	350,455
Treasury	269,845	269,845	283,080	283,080
TOTALS	$11,502,495	$4,900,310	$10,857,005	$4,900,780
Type				
Competitive	$ 9,188,980	$2,586,795	$ 8,003,975	$2,047,750
Noncompetitive	1,155,180	1,155,180	909,530	909,530
Subtotal, Public	$10,344,160	$3,741,975	$ 8,913,505	$2,957,280
Federal Reserve	993,235	993,235	950,000	950,000
Foreign Official Institutions	165,100	165,100	993,500	993,500
TOTALS	$11,502,495	$4,900,310	$10,857,005	$4,900,780

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.343%.

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TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

JAN 11 1982

BIOGRAPHY

ROBERT E. POWIS

Deputy Assistant Secretary (Enforcement)

Mr. Powis was born October 17, 1928, in New York City. He was raised in the New York area. He received a Bachelor's Degree from Fordham University in 1949, an LL.B. from St. Johns University School of Law in 1955. He was admitted to practice in New York State the same year. He served as an officer in the U.S. Marine Corp from 1951 to 1953.

Mr. Powis was in the United States Secret Service for 26 years from 1954 to 1981. At various times he was the Special Agent in Charge of the Scranton, Baltimore and Los Angeles offices of the Service. He was a Deputy Assistant Director for Investigations at Headquarters from 1968 to 1970. During the period March 1978 through June 1981, he served as Assistant Director for Protective Forces and Assistant Director for Investigations. Mr. Powis joined the staff of the Assistant Secretary for Enforcement and Operations in July 1981.

Mr. Powis is married and resides with his wife, Elise, in Fairfax, Virginia. They have six children.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 12:00 NOON January 15, 1982

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $5,250 million, of 364-day Treasury bills to be dated January 28, 1982, and to mature January 27, 1983 (CUSIP No. 912794 BY 9). This issue will provide about $ 575 million new cash for the Treasury, as the maturing 52-week bill was originally issued in the amount of $ 4,684 million.

The bills will be issued for cash and in exchange for Treasury bills maturing January 28, 1982. In addition to the maturing 52-week bills, there are $9,075 million of maturing bills which were originally issued as 13-week and 26-week bills. The disposition of this latter amount will be announced next week. Federal Reserve Banks as agents for foreign and international monetary authorities currently hold $2,669 million, and Federal Reserve Banks for their own account hold $2,367 million of the maturing bills. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $814 million of the original 52-week issue.

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, Thursday, January 21, 1982. 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.

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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 as of 12:30 p.m. Eastern time on the day of 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 January 28, 1982, in cash or other immediately-available funds or in Treasury bills maturing January 28, 1982. 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 Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of. Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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.

TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. January 12, 1982

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $9,800 million, to be issued January 21, 1982. This offering will provide $1,225 million of new cash for the Treasury, as the regular 13-week and 26-week bill maturities were issued in the amount of $8,580 million. The $3,000 million of additional issue 45-day cash management bills issued December 7, 1981, and maturing January 21, 1982, will be redeemed at maturity.

The $8,580 million of regular maturities includes $1,354 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,676 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 $4,900 million, representing an additional amount of bills dated April 23, 1981, and to mature April 22, 1982 (CUSIP No. 912793 7G 5), currently outstanding in the amount of $10,795 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $4,900 million, to be dated January 21, 1982, and to mature July 22, 1982 (CUSIP No. 912794 BE 3).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing January 21, 1982. Tenders from Federal Reserve Banks for themselves and as agents for 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 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. 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, January 18, 1982. 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 as of 12:30 p.m. Eastern time on the day of 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 January 21, 1982, in cash or other immediately-available funds or in Treasury bills maturing January 21, 1982. 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 Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of. Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE January 13, 1982

TREASURY TO AUCTION $5,250 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $5,250 million of 2-year notes to refund $3,994 million of notes maturing January 31, 1982, and to raise $1,256 million new cash. The $3,994 million of maturing notes are those held by the public, including $525 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $491 million of the maturing securities that may be refunded by issuing additional amounts of the new notes at the average price of accepted competitive tenders. Additional amounts of the new security may also be issued at the average price to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing securities held by them.

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

oOo

Attachment

R-568

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED FEBRUARY 1, 1982

January 13, 1982

Amount Offered:	
To the public........................	$5,250 million
Description of Security:	
Term and type of security...........	2-year notes
Series and CUSIP designation........	Series N-1984 (CUSIP No. 912827 MU 3)
Maturity date.......................	January 31, 1984
Call date...........................	No provision
Interest coupon rate................	To be determined based on the average of accepted bids
Investment yield....................	To be determined at auction
Premium or discount.................	To be determined after auction
Interest payment dates..............	July 31 and January 31
Minimum denomination available......	$5,000
Terms of Sale:	
Method of sale......................	Yield auction
Accrued interest payable by investor............................	None
Preferred allotment.................	Noncompetitive bid for $1,000,000 or less
Payment by non-institutional investors...........................	Full payment to be submitted with tender
Deposit guarantee by designated institutions........................	Acceptable
Key Dates:	
Deadline for receipt of tenders.....	Wednesday, January 20, 1982, by 1:30 p.m., EST
Settlement date (final payment due from institutions)	
a) cash or Federal funds.........	Monday, February 1, 1982
b) readily collectible check.....	Thursday, January 28, 1982
Delivery date for coupon securities.	Wednesday, February 10, 1982

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

For Immediate Release
January 14, 1982

Remarks by
Donald T. Regan
Secretary of the Treasury
Thursday, January 14, 1981
before the
Annual Meeting of the Council of U.S. Savings Bonds Volunteers
Washington, D.C.

Good afternoon. I'm glad to be here to lend my personal support to the Council of U.S. Savings Bonds Volunteers -- and your 1982 campaign. I'm also glad to be here to pay thanks to you -- and your colleagues -- for your work on behalf of this fine program. Savings Bonds have played an important role in our nation's history since 1935 -- almost half a century.

Furthermore, the savings generated through bonds mean a lot to those families faced with unseen credit emergencies including the loss of the principal wage earner.

This reminds me of the story about the two guys who loved to play baseball and one day were speculating about the recreational activities in heaven. Joe volunteered to go up and find out. He came back glowing with enthusiasm and told Bill that he had a lot of good news and a little bad news. First, the good news. "Bill," he said, "It's just wonderful up there. Heaven has lovely baseball diamonds, the best of equipment, and they play baseball every day."

"If that's the good news," Bill asked, "What could possibly be the bad news?"

"Well," Joe said, "The bad news is that you are scheduled to pitch next Monday."

There has been some criticism of Savings Bonds in recent years, mostly because the critics feel interest rates have not kept pace with inflation rates and market rates on other instruments. But condemning Savings Bonds because they lost value in such an environment is not the answer. The real problem is the economic climate against which Savings Bonds have been judged.

This month marks the close of the first year of the Reagan Administration in Washington. It has been a time of crisis and renewal -- a year with major problems requiring tough decisions. But it has also been a year in which the President has received the support of the people for a sweeping set of initiatives designed to turn the nation around and restore American strength, prosperity, and greatness.

In the past year our nation has regained its "sense of purpose" and we are fortunate to have Ronald Reagan leading the way.

You may -- or may not -- agree with him politically. You may -- or may not -- support all of his programs. But you cannot fault his character. Of this we can all be proud.

When our Administration took office one year ago, we inherited high rates of interest and the first back-to-back years of double-digit inflation in our history. We faced a situation in which Government taxation and spending were growing faster than the underlying economy.

Federal taxes had nearly quadrupled over the past 15 years, and Federal spending had more than doubled in the past five. Moreover, the Nation had just experienced its second straight year of declining productivity. Americans' personal saving rate was the lowest in 30 years. In January 1981, it was less than 5 percent.

In economics -- as in other forms of human activity -- we find that we reap what we sow. In the United States, we have overspent, overtaxed, overregulated, and overprinted money.

It was with these challenges in mind that the President went to the American people after only 16 days in office with a plan for economic renewal. He wanted to bring inflation down -- to get government off the backs of people and out of their business -- to free up the market place and give people greater incentives to work and to save. His belief: That the creativity and ambition of the American people -- freed of obstacles -- are the vital forces of economic growth.

In introducing his plan to the Nation that evening a year ago, President Reagan said, "It's time to recognize that we've come to a turning point. We're threatened with an economic calamity of tremendous proportions, and the old business-as-usual treatment can't save us. Together, we must chart a different course."

His prescription for recovery is labeled "Reaganomics."

This is a handy term to indicate something different from the old approaches. But it can also be misleading to the extent that it implies some mysterious new formula.

Reaganomics is neither new nor mysterious. What this term does convey is the old idea that you can't run a country, or a business, without providing the incentives that will increase the supply of goods, labor, and capital.

Simply put, it means: the less we tax, the more we can save. The more we save, the more we can produce. And the more we produce, the more we can provide for all.

The Administration's approach is based on three fundamental convictions:

First, there is no more efficient mechanism for allocating resources than the free market.

Second, market economies have strong self-correcting features. This is not to say, of course, that if we leave everything alone it will all take care of itself. But it is to say that the self-corrective forces at work in the market place are powerful and that they need to be allowed to function.

Third, economic systems have the dynamic capacity to create -- to create new wealth where it simply did not exist before. Japan, a country whose productivity performance is often cited as a model, is a good example of this. Devastated by war, located on a relatively small island with precious few natural resources, and no oil, it has emerged since the War as one of the preeminent economic powers in the world.

The President's plan is now in place. As you know, it has four interrelated and interdependent parts:

* <u>Tax Cuts</u>: While not fully in effect at this time, tax rate cuts are in place, and declining interest rates will reinforce the impact of the cuts. These are bold cuts for both business and individuals -- tax cuts designed to encourage saving, investment, and growth. In 1985, and thereafter, tax rates will be indexed to inflation, preventing government from devouring future earnings and benefitting from inflation -- bracket creep -- at the expense of the individual.

* <u>Monetary Policy</u>: The goal here is to bring a permanent end to stop-and-start monetary policy. We want to keep a balance between feast and famine -- between swelling the money supply too quickly, spinning us back into the inflationary cycle -- and shrinking it too much, giving us a protracted recession. Steady and moderate monetary and fiscal policies will control inflation and reduce the presence of government in the economy, thereby creating a more fertile and predictable environment for private business decisions.

* <u>Government Regulations</u>: Across the board, Americans continue to tell us that they do not need officials of government to make their decisions and to direct their lives. Workers, businessmen, consumers, savers, and investors -- people of all trades and concerns -- tell us they know best what they want and how properly to attain it. Chaired by Vice President Bush, the Task Force on Regulatory Relief has already taken action estimated to

yield savings of about $2 billion a year in operating costs and $5 billion in one-time capital investment costs. There has also been a significant slowing of new regulations flowing out of Washington -- down almost 50 percent.

* Reducing Growth in Government Spending: For 26 of the last 30 years, the Federal Government has been running on red ink. Our national debt is enormous -- over a trillion dollars. Interest payment on this debt is now the third largest item in the Federal budget -- immediately behind defense and social programs. Regardless of what the deficits look like in 1982 and beyond, President Reagan is firmly committed to having government absorb a smaller portion of the gross national product. We are going to cut Federal spending again and again until we are able to live within our means.

There has been a lot of talk about budget deficits -- some figures have been leaked around town -- and many people are confused regarding the Administration's position. Let me say at this time that we are committed to reducing the deficit and working toward a balanced budget.

While seeking to restrain the growth in federal spending, President Reagan also remains committed to providing basic human services. He believes that government can remain compassionate as it also becomes more efficient. Thus, in 1982, under the Administration's program:

-- The Federal Government will subsidize about 100 million meals a day.

-- About 40 million people will receive $50 billion in cash and in-kind benefits from eight major federal assistance programs.

-- Nearly 4 million more people will receive food stamps in 1982 than in 1975, a recession year.

Now, how is this program of steady money supply, new tax philosophy, fewer regulations, and budget cuts working?

It is working. But total success won't occur overnight. We are dealing with the most complicated economy in the world and one that has been twisted into odd shapes by decades of deficit spending. For years we have been launching one new Federal program after another, and then borrowing from tomorrow to pay the bills for today. Furthermore, we have been banking on inflation and bracket creep taxation to bail us out.

This reminds me of a story. Three individuals died: a surgeon, an engineer, and an economist. They arrived at the gates of heaven at the same time. St. Peter was very concerned.

He says, "We have a little problem here fellas. I only have a place for one of you inside and there are three of you here. How do we choose the lucky person?"

So he thought for a while and finally said, "I think I've come up with an idea. See if you all agree. I'll choose the man who has the oldest profession."

They all said, "Fine" -- that seemed fair to them.

The surgeon spoke up, "I certainly am the man with the oldest profession when you consider the fact that right after God created Adam, he operated on Adam, took out a rib and created Eve. So surgery is the oldest profession."

The engineer said, "Wait one second, here. Before God created Eve or Adam, he took chaos and built the Earth in six days. Engineering obviously preceded surgery."

The economist says, "Hold up, fellows. Hold up. Who do you think created all that chaos?"

As we try to bring order out of chaos and bring inflation down -- and we are achieving some success -- this very success is adding to our deficit problems in 1982. This is because as the rate of inflation drops, the immediate effect is less growth in nominal tax revenues.

However, there are a number of recent economic indicators that are bearing good news. The Consumer Price Index for October and November averaged a modest 0.45 percent (5.3 percent at an annual rate compared to 9.2 percent average earlier in the year).

Overall, I am encouraged by our progress over the past year and we'll continue to do just as well -- or better -- in 1982. The inflation rate has declined by one-fifth -- dropping from 12-1/2 percent down below 10. Interest rates are on the way down -- we got the prime rate down from 21-1/2 to 15-3/4. The dollar is strong and once again a source of stability. We are confident that the President's program -- when given a chance to work -- will allow for a strong resurgence and revitalization of the American economy. And with this revitalization will come real increases in productivity.

In the thrift area, the President's program provides real incentives for people and business to save and invest. Americans' personal savings rate -- the lowest in the industrialized world, has risen from 4.6 percent last January to 5.9 percent in October and November, the first month of the tax cut.

Saving is something people choose to do -- or not to do -- depending on the reward.

When taxes and high inflation penalize savings, people will stop. When policies encourage savings, people will save.

The U.S. Savings Bonds program has an important role in our overall savings effort. Payroll savings is the program's backbone -- it accounts for 80 percent of all Savings Bonds sales.

That's why we put so much emphasis on payroll savings. That's why company and corporate leaders like you are the crucial link in helping us sell the program.

The current interest rate of 9 percent for Savings Bonds held to maturity is good but not great. Interest rates on some other savings and investment instruments are higher.

Nevertheless -- buying bonds through payroll savings -- does provide an easy, convenient, and systematic way to put aside money in safety.

In payroll savings, money is saved at the source -- the paycheck -- before the money is in hand and one is tempted to spend it. This may not be the most sophisticated way to save, but it is practical, and -- more importantly -- it works.

The Savings Bonds program is important to the government because it helps us meet obligations on our public debt in the most cost-effective manner possible. The $68 billion in outstanding bonds is $68 billion the government does not need to borrow from the already overcrowded securities markets.

To strengthen the Savings Bonds program, we will be sending to the Congress legislation to establish a new rate for bonds held at least 5 years. That rate would be 85 percent of the average return on 5-year Treasury securities during the holding period.

For example, if you buy a savings bond and redeem it after 5 years, and if the average rate for 5-year marketables during the holding period was 12.5 percent, your bonds would earn 10.6 percent upon their redemption.

Furthermore, if you are currently holding a bond purchased under an existing fixed rate schedule, and if that bond is held another five years, it would automatically receive the new 85 percent rate for that 5 year period if that rate is higher than the fixed rates already promised.

The new market-based interest rate will assure savings bond holders of a fair return regardless of movements in market rates of interest, and thus will help assure a greater participation in the Savings Bonds program.

We are urging speedy action by the Congress, perhaps as early as next month.

The change will provide needed improvement for the small saver who has been loyally participating in the program.

It will provide an incentive to the nonsaver -- a reason to enroll in payroll savings.

It will help our government by reducing the need for borrowing in the public money markets.

The Treasury faces large borrowing requirements over the next several months. A viable, modern Savings Bonds program will help us meet these financing needs in an efficient, cost-effective manner.

The success of the Savings Bonds drive across the country -- and in your companies -- depends on support from the top -- your leadership and your enthusiasm -- and a company program which stresses one-on-one contact.

In closing, let me once again say "thank you" for your past and present support of the Savings Bonds program. I know that you receive many requests for your time and assistance and the thanks are often meager. Be assured, we do value your support and we do know how important you are to this job.

Thank you.

# # #

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
Monday, January 18, 1982

CONTACT: Marlin Fitzwater
(202) 566-5252

TREASURY - IRS TO HOLD ACTION ON TAX EXEMPTIONS

Recognizing the President's desire to have legislation introduced to prohibit the granting of tax exemptions to certain educational institutions that engage in racially discriminatory practices, the Secretary of Treasury has instructed the Commissioner of Internal Revenue not to act on any applications for tax exemptions filed in response to the Internal Revenue Service's policy announced on Friday, January 8, 1982, until Congress has acted on the proposed legislation (except as required by the memorandum in support of the motion to vacate as filed in the Supreme Court on January 8, 1982.)

R-570

TREASURY NEWS
partment of the Treasury • Washington, D.C. • Telephone 566-2041

December 30, 1981

ROY GORDON HALE
DEPUTY TREASURER OF THE UNITED STATES

Roy Gordon Hale, 43, was appointed Deputy Treasurer of the United States on May 1, 1981.

The Treasurer of the United States is responsible for the administration of the Bureau of Engraving and Printing, the Bureau of the Mint, and the U.S. Savings Bonds Division. With the rank of Deputy Assistant Secretary, Mr. Hale assists the Treasurer in the management of the office of the Treasurer and these three Treasury Department bureaus.

The Bureau of Engraving and Printing is the world's largest securities manufacturing establishment. It designs and produces United States currency, postage stamps, public debt securities, and other miscellaneous financial documents issued by the United States. More than one-half million visitors tour the facility annually to observe how the nation's currency is produced.

The Bureau of the Mint is tasked with manufacturing an adequate volume of coins for the nation's trade and commerce. The Mint also manufactures commemorative medals; manufactures and sells proof coin sets and gold medallions; produces foreign coins under contract; has custody of more than 260 million ounces of U.S. owned gold stored at Fort Knox and five other locations; processes, refines and transports gold and silver bullion; disburses gold and silver for authorized purposes; distributes coins for general circulation through the Federal Reserve Banks and its branches; and compiles general data of worldwide scope relative to gold and silver (refining and sales) and coins (alloys, weights, physical dimensions and volumes produced).

The U.S. Savings Bonds Division, a bureau-level organization, has the principal mission of promoting the sale and retention of U.S. Savings Bonds. Some 23 million families currently hold savings bonds totalling more than $70 billion.

Before his appointment on May 1, Mr. Hale served as Deputy Controller for the Presidential Transition Team and as an accountant for the Reagan-Bush Committee.

Prior to August 1980, Mr. Hale holds a Bachelor of Science Degree in accounting from the University of Maryland and is licensed to practice as a Certified Public Accountant in Maryland.

Mr. Hale is married to the former Elizabeth Ann Moore of Waynesburg, Pennsylvania, and has two sons, Steven age 15 and David age 10. He resides in La Plata, Maryland. Mr. Hale enjoys sports and has been active as coach and player in football and baseball.

TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE January 18, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 4,902 million of 13-week bills and for $4,900 million of 26-week bills, both to be issued on January 21, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 22, 1982			:	26-week bills maturing July 22, 1982		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.878 a/	12.351%	12.93%	:	93.406 b/	13.043%	14.16%
Low	96.818	12.588%	13.18%	:	93.347	13.160%	14.29%
Average	96.839	12.505%	13.09%	:	93.376	13.102% 2/	14.23%

a/ Excepting 1 tender of $100,000.
b/ Excepting 4 tenders totaling $2,910,000.

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

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 78,840	$ 78,840	:	$ 95,275	$ 65,275
New York	7,169,705	3,463,455	:	7,718,740	3,743,640
Philadelphia	43,930	43,930	:	22,410	22,410
Cleveland	74,955	71,955	:	101,595	65,595
Richmond	47,945	47,945	:	70,610	70,610
Atlanta	67,305	67,305	:	72,020	71,020
Chicago	918,930	512,930	:	592,240	144,240
St. Louis	50,190	42,490	:	37,090	27,090
Minneapolis	11,290	11,290	:	22,730	22,730
Kansas City	65,285	65,285	:	58,780	58,780
Dallas	26,805	26,805	:	27,835	22,835
San Francisco	531,030	181,030	:	735,035	330,685
Treasury	288,745	288,745	:	255,345	255,345
TOTALS	$9,374,955	$4,902,005	:	$9,809,705	$4,900,255
Type					
Competitive	$7,142,815	$2,869,865	:	$7,512,180	$2,802,730
Noncompetitive	1,231,710	1,231,710	:	885,425	885,425
Subtotal, Public	$8,374,525	$4,101,575	:	$8,397,605	$3,688,155
Federal Reserve	851,130	651,130	:	825,000	625,000
Foreign Official Institutions	149,300	149,300	:	587,100	587,100
TOTALS	$9,374,955	$4,902,005	:	$9,809,705	$4,900,255

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.659%.

R-572

The Center for Strategic and International Studies
Georgetown University / 1800 K Street Northwest / Washington DC 20006 / Telephone 202 / 887-0200
Cable Address: CENSTRAT
TWX: 7108229583

FOR IMMEDIATE RELEASE
Monday, January 18, 1982

FOR INFORMATION CONTACT:
Sterling G. Slappey
(202) 775-3265

DR. ROBERTS TO OCCUPY SIMON CHAIR AT CSIS

WASHINGTON--A five-member selection committee has unanimously chosen Dr. Paul Craig Roberts to occupy the newly established William E. Simon Chair for Political Economy at the Georgetown University Center for Strategic and International Studies.

The appointment to the chair is effective February 1, 1982. Dr. Roberts was notified of his selection for the chair on December 9, 1981 and has now informed the Center of his acceptance.

Dr. Roberts has served for the past year as Assistant Secretary of the Treasury for Economic Policy. He formerly was a Senior Fellow at the Georgetown Center, an associate editor of the editorial pages of The Wall Street Journal, and an economic advisor on Capitol Hill.

The chair selection committee was composed of Dr. Fred Seitz, Chairman, President Emeritus of Rockefeller University; Dr. David M. Abshire, Chairman of the Center; Dr. Amos Jordan, Vice Chairman of the Center; Dr. J. Clayburn La Force, Dean of the Graduate School of Management at UCLA, and Dr. Richard Schwartz, Dean of the Graduate School at Georgetown University.

Dr. Roberts will be the first occupant of the Simon Chair. The chair was inaugurated at a Center dinner held July 2, 1981

(more)

attended by President Ronald Reagan. It is named for former Secretary of the Treasury William E. Simon.

The purpose of the chair will be to study and teach the relationships between political and economic activities in a free society. The chair is endowed with $2 million pledged by 20 donors. Mr. Justin Dart, Chairman of the Executive Committee of Dart & Kraft Inc., chaired the 17-member William E. Simon Chair Committee.

Mr. Simon is a member of the Center's International Councillors, chaired by Dr. Henry A. Kissinger, who is a Senior Counselor at the Center. Mr. Simon was for a number of years a Director of Georgetown University and a member of the 99-member CSIS Advisory Board, now chaired by The Honorable Anne Armstrong.

The Chair Fundraising Committee was: Justin Dart, Chairman, Anne Armstrong, Charles L. Bartlett, Archer Boe, George Champion, Marshall B. Coyne, J. Peter Grace, John P. Harbin, Jacqueline H. Hume, Suliman Olayan, John Merrill Olin, John M. Richman, Stanley M. Rumbough, Jr., Frank Shakespeare, George Shultz, Holmes Tuttle, Walter B. Wriston.

The Chair Donors are: Archer Daniels Midland Company, Dwayne P. Andreas, Chairman of the Board; Bechtel Group, Inc., Stephen D. Bechtel, Jr., Chairman of the Board; The Boeing Company, T. A. Wilson, Chairman of the Board; Chase Manhattan Corporation, Willard C. Butcher, Chairman of the Board; Citicorp, Walter B. Wriston, Chairman of the Board; Dart & Kraft, Inc., John M. Richman, Chairman of the Board; Dow Chemical Company, Paul F. Oreffice, President; Fluor Corporation, J. Robert Fluor, Chairman of the Board; W. R. Grace and Company, J. Peter Grace, Chairman of the Board; Halliburton Co., John P. Harbin, Chairman of the Board; International Business Machines Corporation, Frank T. Cary, Chairman of the Board; Occidental Petroleum Corporation, Armand Hammer, Chairman of the Board; Olayan Group of Companies, Suliman L. Olayan, Chairman of the Board; Olin Foundation, Inc., Michael L. Joyce, Executive Director; PepsiCo, Inc., Donald M. Kendall, Chairman of the Board; Smith Kline Corporation, Robert F. Dee, Chairman of the Board; United Technologies Corporation, Harry J. Gray, Chairman of the Board; The Western Copany of North America, H. E. Chiles, Chairman of the Board; Whittaker Corporation, Joseph F. Alibrandi, President; Xerox Corporation, C. Peter McColough, Chairman of the Board.

Dr. Roberts was Chief Economist of the Minority Staff Budget Committee in the U.S. House of Representatives, 1976-77. He holds a Bachelor of Science degree from Georgia Institute of Technology and a Ph.D. in Economics from the University of Virginia and pursued graduate studies in economics at the University of California, Berkeley, and at Oxford where he is a member of Merton College. He has held a number of academic appointments including Virginia Polytechnic Institute, Tulane, and Stanford, where he is a Senior Research Fellow at the Hoover Institution.

Dr. Roberts is the author of several books and well over 50 articles and reviews, including two extremely well-received books on Marxian theory. They are: Alienation and the Soviet Economy: Towards a General Theory of Marxian Alienation, Organizational Principles, and the Soviet Economy (Albuquerque: University of New Mexico Press, 1971); Marx's Theory of Exchange, Alienation and Crisis (Stanford, CA: Hoover Institution Press, 1973) co-authored with M. A. Stephenson.

His articles cover a wide range of topics, from "Morality and American Foreign Policy" (Modern Age, Spring 1977), "American Diplomacy and International Business" (Vital Speeches, June 15, 1979), to "The Concept of Planning in the Soviet Union: (A Journal of East and West Studies, Autumn 1973). In addition, he has produced numerous contributions to scholarly journals in the field of economic affairs.

Dr. Abshire said, "It is with great enthusiasm that we welcome Dr. Roberts back to the Center. It is particularly significant that an individual of his professional standing should occupy this first-of-the-Center's endowed chairs and we look forward with great anticipation to the significant work that he is planning."

Professor La Force said in support of Dr. Robert's nomination to the Chair: "From personal observation, I know that Dr. Roberts is a man of high ethical standards and shares those values and ideals so eloquently stated in the Charter of the William E. Simon Chair. He is an ideal candidate."

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

January 8, 1982

President Ronald Reagan
The White House

Dear Mr. President:

On December 9 I was informed that I was the unanimous choice of the selection committee as the first occupant of the William E. Simon Chair in Political Economy at the Center for Strategic and International Studies, Georgetown University. This is an extraordinary opportunity, and one that my wife and I have decided that I must accept in spite of deep regret at leaving the Treasury and the Reagan Administration. I felt that you would approve my decision since you showed your support for the Simon Chair by attending the inaugural dinner at the International Club where Justin Dart announced the $2 million gift endowing the chair. I have spoken to Secretary Regan, informing him that I would be submitting my resignation effective February 1, 1982, or thereabouts at the Treasury's convenience.

As you know, I greatly admire your leadership. I have followed it to the letter and have enjoyed all the hard work in support of your economic program. I am certainly proud to be part of the effort that you have undertaken to rejuvenate the United States economy. I am grateful for the opportunity that you gave me to serve the American people.

Much lies ahead in the economic struggle, and you can count on my continuing support in my new position a few blocks away.

Yours faithfully,

Craig Roberts

Paul Craig Roberts
Assistant Secretary for
Economic Policy

SSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 8, 1982

Hon. Donald T. Regan
Secretary of the Treasury

Dear Don:

On December 9 I was informed that I was the unanimous choice of the selection committee as the first occupant of the William E. Simon Chair in Political Economy at the Center for Strategic and International Studies, Georgetown University. This is an extraordinary opportunity, and one that my wife and I have decided that I must accept in spite of deep regret at leaving the Treasury and the Reagan Administration.

As you know I admire your leadership and the superb job you are doing as Secretary of the Treasury. I value the opportunity I have had to work for you and to learn from you.

The President's leadership is phenomenal. To work hard in support of his program is really a pleasure. I am certainly proud to be a part of the effort that the President has undertaken to rejuvenate the United States economy.

I know that it is protocol for me to submit my resignation to the President, who appointed me, but I wanted first to inform you that I would be submitting my resignation effective February 1, 1982, or thereabouts at the Treasury's convenience.

Much lies ahead in the economic struggle, and you can count on my continuing support in my new position a few blocks away. If it is helpful to you and the President, I would be willing to serve on any commissions or task forces to which you think I might contribute.

Yours faithfully,

Craig

Paul Craig Roberts
Assistant Secretary
for Economic Policy

THE WHITE HOUSE

WASHINGTON

January 18, 1982

Dear Craig:

Thank you for your letter of January 8. It is with regret that I accept your resignation as Assistant Secretary of the Treasury for Economic Policy, effective February 1, 1982. Your contributions to the development of our Economic Recovery Program have been extremely valuable, and I am deeply appreciative of them. We will miss your keen analysis and your consistently vigorous effort in the further development of our plan; but I am grateful that I can count on your continuing support.

While I regret your leaving, I am gratified to learn of the prestigious academic position that you are accepting. As you know, I had the honor of announcing last summer the establishment of the William E. Simon Chair in Political Economy at the Georgetown Center. It is indeed fitting and gratifying that yours should be the first appointment to this distinguished Chair.

I know that Georgetown, and the larger community, will benefit greatly from the clarity of your economic insights and the intensity of your concern for broader policy interests.

With best wishes for continued success,

Sincerely,

Ronald Reagan

The Honorable Paul Craig Roberts
Assistant Secretary of the Treasury
Washington, D.C. 20220

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

January 18, 1982

Dear Craig:

It is with a real sense of loss, both to myself and the Treasury Department, that I receive your resignation as Assistant Secretary for Economic Policy. However, I share your excitement at becoming the first occupant of the William E. Simon Chair in Political Economy at the Center for Strategic and International Studies, Georgetown University.

Your advice and counsel in formulating the President's Economic Recovery Program has been invaluable. I recall the long sessions last winter when we rolled up our shirtsleeves to put this program together. It was your vision and economic philosophy that gave purpose and dimension to the program.

You deserve considerable credit for passage of the Economic Recovery Tax Act of 1981. Your patient and articulate explanations of supply side economics were essential to adoption of this historic law. I believe that we have fashioned a new foundation for political economic thinking in this country and your contributions have been central to that accomplishment.

The President has set a new course for this nation, but much remains to be done. I look forward to working with you in the months ahead as these tasks continue. I thank you for your personal and professional support while at Treasury, and I offer my best wishes for great success in your new position at Georgetown University.

Sincerely,

Don

Donald T. Regan

The Honorable
Paul Craig Roberts
Assistant Secretary
for Economic Policy

TREASURY NEWS
partment of the Treasury • Washington, D.C. • Telephone 566-2

FOR IMMEDIATE RELEASE
Monday, January 18, 1982

Contact: Marlin Fitzwater
(202) 566-5252

JOHNSON NAMED ACTING ASSISTANT SECRETARY
FOR ECONOMIC POLICY

Secretary of the Treasury Donald T. Regan today named Dr. Manuel H. Johnson, age 32, as Acting Assistant Secretary for Economic Policy effective February 2.

Dr. Johnson is currently Deputy Assistant Secretary for Economic Policy. On an Acting basis, he will replace Dr. Paul Craig Roberts, who has resigned effective February 1, to occupy the William E. Simon Chair in Political Economy at the Center for Strategic and International Studies, Georgetown University.

Prior to joining the Treasury Department on April 27, 1981, Dr. Johnson was an associate professor of economics in the graduate school at George Mason University and was an adjunct scholar of the Heritage Foundation.

Dr. Johnson was educated at Troy State University (B.S., Economics), and Florida State University (M.S. and Ph.D., Economics).

TREASURY NEWS
partment of the Treasury • Washington, D.C. • Telephone 566-2

FOR RELEASE AT 4:00 P.M. January 19, 1982

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $10,000 million, to be issued January 28, 1982. This offering will provide $ 925 million of new cash for the Treasury, as the maturing bills were originally issued in the amount of $9,075 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 5,000 million, representing an additional amount of bills dated October 29, 1981, and to mature April 29, 1982 (CUSIP No. 912794 AN 4), currently outstanding in the amount of $ 4,728 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 5,000 million, to be dated January 28, 1982, and to mature July 29, 1982 (CUSIP No. 912794 BF 0).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing January 28, 1982. In addition to the maturing 13-week and 26-week bills, there are $4,684 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Federal Reserve Banks, as agents for foreign and international monetary authorities, currently hold $2,534 million, and Federal Reserve Banks for their own account hold $2,367 million of the maturing bills. These amounts represent the combined holdings of such accounts for the three issues of maturing bills.

Tenders from Federal Reserve Banks for themselves and as agents for 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 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $1,720 million of the original 13-week and 26-week issues.

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, January 25, 1982. 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 as of 12:30 p.m. Eastern time on the day of 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 January 28, 1982, in cash or other immediately-available funds or in Treasury bills maturing January 28, 1982. 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 Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of. Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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.

FOR IMMEDIATE RELEASE
Wednesday, January 20, 1982

STATEMENT BY
THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY
TO
ADMINISTRATION APPOINTEES

WEDNESDAY, JANUARY 20, 1982

I APPRECIATE THIS OPPORTUNITY TO MEET WITH SO MANY FELLOW MEMBERS OF IN THE REAGAN ADMINISTRATION. A LITTLE LESS THAN A YEAR AGO WE WERE BURNING THE MIDNIGHT OIL TO FASHION AN ECONOMIC RECOVERY PROGRAM FOR THIS NATION. OVER AT THE TREASURY DEPARTMENT WE WERE PRETTY EXCITED AT THE PROSPECT OF A NEW ECONOMIC PHILOSOPHY, A DETERMINED TEAM EFFORT, AND CLEARSIGHTED PRESIDENTIAL LEADERSHIP.

TODAY, AFTER ALMOST A YEAR OF MEETINGS AND INNUMERABLE SCRAMBLED EGG BREAKFASTS WITH DAVE STOCKMAN, MURRAY WEIDENBAUM, AND MARTY ANDERSON, I BELIEVE WE HAVE AN ENVIABLE RECORD TO SHOW. AND WHILE OUR EXCITEMENT IS TEMPERED WITH EXPERIENCE, AND OUR SKINS ARE THICKER, I ALSO BELIEVE WE HAVE THE SAME DEDICATED AND DETERMINED ATTITUDE OF THOSE EARLY DAYS.

SO I COME TO YOU TODAY WITH A CLEAR PICTURE OF WHERE WE ARE AND WHERE WE'RE GOING -- IT'S ONE OF THOSE BEFORE AND AFTER PICTURES THAT SHOW A SLEEKER, TRIMMED DOWN VERSION OF WHAT WAS ONCE AN OBESE, AND RUMPLED FEDERAL GOVERNMENT.

AFTER THE HEADY SUCCESSES OF THIS SUMMER, IT IS HARD TO BEAR THE DOUBTS, CRITICISM AND SIGNS OF IMPATIENCE OVER THE CURRENT STATE OF THE ECONOMY AND THE ECONOMIC PROGRAM THAT SEEM TO BE ARISING FROM ALL QUARTERS. LET ME ASSURE YOU THAT THE ECONOMIC PROGRAM IS ON TRACK, AND THAT THE ECONOMY WILL BE ON TRACK VERY SOON.

OUR PROGRAM IS LONG-TERM AND COMPREHENSIVE; AND IT HAS BARELY BEGUN. THE FIRST AND SMALLEST ROUND OF TAX CUTS HAS BEEN IN EFFECT LESS THAN 90 DAYS, OTHER CUTS PHASED IN 20 DAYS AGO AND TRULY SIGNIFICANT CUTS WILL BEGIN NEXT SUMMER.

TO SAY OUR POLICIES AREN'T WORKING IS LIKE SAYING -- WHILE THE OPENING KICK-OFF IS STILL IN THE AIR -- THAT THE REDSKINS ARE BEHIND. IN THE LAST FEW MONTHS, INFLATION HAS COME DOWN. INTEREST RATES ARE DOWN; AND THERE IS ALREADY AN IMPROVEMENT IN THE RATE OF PERSONAL SAVINGS. WAIT UNTIL THE MARKET PLACE REALLY CATCHES THOSE TAX INCENTIVES AND STARTS TO RUN, BEFORE PASSING JUDGEMENT ON WHICH WAY THE GAME IS GOING.

THE ECONOMIC MESS THAT WE INHERITED COULD HARDLY HAVE BEEN WORSE. AND IT IS GOING TO TAKE SOME TIME TO TURN THIS THING AROUND. NOT ONLY WERE ALL THE MAJOR ECONOMIC TRENDS GETTING WORSE, BUT THE PREVIOUS ADMINISTRATION HAD NO PLANS FOR COPING. WE CAME IN WITH A CLEAR PICTURE OF THE CAUSES OF THE TROUBLE AND A CLEAR PROGRAM DESIGNED TO SET THINGS STRAIGHT.

THE ECONOMY IN 1980 WAS STAGGERING UNDER A LONG SERIES OF INEFFECTIVE STOP AND GO POLICIES WHICH HAD PRODUCED FOUR YEARS OF RISING INFLATION, RISING INTEREST RATES, RISING TAX RATES, AND RISING FEDERAL SPENDING AS A SHARE OF GNP. ONLY THE GOOD THINGS WERE FALLING -- THINGS LIKE REAL TAKE-HOME PAY AND PRODUCTIVITY. AFTER TWO YEARS OF DOUBLE DIGIT INFLATION AND INTEREST RATES, AND SHARPLY HIGHER TAX RATES SINCE THE LAST TAX CUT IN 1978, THE ECONOMY WAS ON THE BRINK. AUTOS AND HOMEBUILDING WERE COLLAPSING. CREDIT CONTROLS WERE THE LAST STRAW, TRIGGERING THE SHARP COLLAPSE WHICH BECAME THE RECESSION OF 1980.

AFTER CONTROLS ENDED, THE ECONOMY STRUGGLED TO RECOVER, GROWING THROUGH THE FIRST QUARTER OF 1981. BUT THE CAUSES OF THE RECESSION WERE NOT CORRECTED, AND THERE WAS A RENEWED SLUMP. THE CAUSES WERE THE SAME: CONTINUED HIGH INFLATION AND INTEREST RATES, AND RISING TAX RATES. BY THE SPRING OF 1981, AUTOS HAD BEEN TOTALLED AND CONSTRUCTION WAS AT A STANDSTILL. INDUSTRIAL PRODUCTION WAS PRACTICALLY FLAT FROM MARCH TO JULY. BY JULY, IT WAS FALLING.

LET ME REPEAT. BY SPRING IT WAS FLAT. BY JULY IT WAS FALLING. BEFORE THE TAX BILL TOOK EFFECT. BEFORE THE MAJOR BUDGET CUTS. BEFORE THE REAGAN PROGRAM.

THOSE WHO BLAME REAGANOMICS FOR THE CURRENT SLUMP MUST BELIEVE IN RETROACTIVE CAUSATION, AND THAT THE ECONOMY, LIKE MERLIN, MAGICALLY LIVES BACKWARDS IN TIME!

WE INHERITED THIS MESS. BUT WE UNDERSTAND ITS CAUSES. TO CORRECT THE ERRORS OF THE PAST, AND TO RESTORE ECONOMIC GROWTH AND FULL EMPLOYMENT WHILE REDUCING INFLATION, A FOUR PART PROGRAM WAS CREATED. IT CONSISTS OF:

1. SLOWING THE GROWTH OF FEDERAL SPENDING. THIS IS NOT AN IDEOLOGICAL GOAL. IT IS A NECESSARY STEP TO RETURN THE REAL AND FINANCIAL RESOURCES NOW BEING ABSORBED BY THE GOVERNMENT TO THE PRIVATE SECTOR, WHERE IT CAN BE USED FOR INVESTMENT AND GROWTH.

2. AN INCENTIVE TAX POLICY. THIS IS NOT A RANDOM TAX CUT TO GIVE AWAY MONEY -- ONLY TO HAVE THE GOVERNMENT BORROW IT BACK. IT IS A CAREFULLY STRUCTURED TAX CUT TO RAISE THE REWARDS ~~TO~~ FOR EACH HOUR WORKED AND EACH DOLLAR SAVED, TO ENCOURAGE PEOPLE TO SUPPLY MORE EFFORT, MORE SAVING AND MORE INVESTMENT TO THE ECONOMY.

3. A NON-INFLATIONARY MONETARY POLICY, DESIGNED TO END INFLATION AND REDUCE THE HIGH INTEREST RATES AND RISING TAX RATES THAT INFLATION PRODUCES.

4. REGULATORY REFORM, TO REDUCE THE INEFFICIENCIES AND ENORMOUS COSTS THAT ARE HOLDING BACK PRODUCTION AND RAISING PRICES.

LARGE PARTS OF OUR PROGRAM ARE IN PLACE.

WE HAVE ACHIEVED SUBSTANTIAL REDUCTION IN THE GROWTH OF FEDERAL SPENDING. SPENDING HAD BEEN RISING AT 13 PERCENT PER YEAR UNDER THE CARTER BUDGETS THROUGH FY 1981, RISING FROM 21.6 PERCENT OF GNP IN FY 77 WHEN PRESIDENT FORD LEFT OFFICE TO A RECORD 23.1 PERCENT IN FY 81. THE SPENDING REDUCTIONS ALREADY ENACTED AND THOSE STILL TO BE PROPOSED, COUPLED WITH FASTER ECONOMIC GROWTH, WILL BRING US CLOSER TO OUR LONG TERM GOALS OF 19 TO 20 PERCENT OF GNP IN THE YEARS AHEAD.

THE ECONOMIC RECOVERY TAX ACT OF 1981 IS IN PLACE. THE ACCELERATED COST RECOVERY SYSTEM INCREASES THE INVESTMENT TAX CREDIT, AND SHORTENS AND SIMPLIFIES THE DEPRECIATION SCHEDULES. IT WILL RESTORE A REASONABLE RATE OF RETURN ON INVESTMENT IN PLANT AND EQUIPMENT. FOR THE FIRST TIME IN YEARS, FIRMS WILL BE ALLOWED A TAX WRITE OFF LARGE ENOUGH TO LET THEM REPLACE THEIR PLANT AND EQUIPMENT, THE COSTS OF WHICH HAVE BEEN RISING SHARPLY WITH INFLATION.

PERSONAL TAX RATE REDUCTIONS OF NEARLY 25 PERCENT OVER THREE YEARS WILL KEEP WORKERS AND SAVERS AHEAD OF BRACKET CREEP, UNTIL THE TAX CODE IS FINALLY INDEXED IN 1985. UNDER THE THREE YEAR INCENTIVE TAX RATE REDUCTION, AFTER TAX WAGES, INTEREST AND DIVIDENDS WILL RISE. THE COST OF HIRING AND BORROWING WILL FALL. THE BRACKET CREEP WHICH HAD DISCOURAGED U.S. LABOR, AND PRICED IT INCREASINGLY OUT OF WORLD MARKETS, IS AT AN END. THE RISING MARGINAL TAX RATES WHICH, WITH INFLATION, HAVE CUT PERSONAL SAVINGS RATES IN ALL BRACKETS ALMOST IN HALF BETWEEN 1975 AND 1980, WILL BE REDUCED. DISCRIMINATORY TAX RATES ON INCOME FROM SAVING HAVE BEEN ENDED, AND THE MARRIAGE PENALTY HAS BEEN REDUCED.

REGULATORY REFORM IS UNDER WAY, DIRECTED BY THE VICE PRESIDENT'S REGULATORY TASK FORCE AND YOU'LL HEAR MORE ABOUT THAT FROM HIM.

MONETARY POLICY HAS SHIFTED TOWARD REDUCING INFLATION. WE HAVE ENCOURAGED THE FEDERAL RESERVE TO KEEP MONEY GROWTH AT LEVELS CONSISTENT WITH A GRADUAL RETURN TO STABLE PRICES.

THESE POLICIES ARE JUST BEGINNING. IT WILL TAKE TIME FOR THEM TO WORK. THE PUBLIC UNDERSTANDS THIS. POLLS INDICATE THAT THE PEOPLE BELIEVE THE ECONOMIC RECOVERY PROGRAM WILL TURN THE ECONOMY AROUND, AND THAT THEY ARE WILLING TO GIVE IT TIME TO WORK.

IN FACT, THERE ARE SIGNS OF PROGRESS ALREADY:

CONSUMER PRICES, WHICH ROSE 12.4 PERCENT DURING 1980, ARE LIKELY TO FINISH 1981 JUST OVER 9 PERCENT, AND CONTINUE TO SLOW IN THE MONTHS AHEAD.

PRODUCER PRICES, WHICH ROSE 11.8 PERCENT DURING 1980, ROSE ONLY 7.0 PERCENT IN 1981, AND INDICATE CONTINUED MODERATION AT THE CONSUMER LEVEL.

INTEREST RATES, DRIVEN BY INFLATION, REACHED RECORD HIGHS IN THE LAST TWO YEARS, BUT HAVE SINCE FALLEN. THE PRIME RATE WAS 21-1/2 PERCENT A YEAR AGO, AND IS NOW AT 15.75. TREASURY BILLS WERE OVER 15.5 PERCENT A YEAR AGO, AND ARE NOW UNDER 12.5.

AS THE NEXT ROUND OF TAX RATE REDUCTIONS TAKE EFFECT IN JULY, AND AS FIRMS BEGIN TO TAKE ADVANTAGE OF INVESTMENT OPPORTUNITIES OPENED UP BY THE NEW TAX BILL, A STRONG RECOVERY IS LIKELY BY MID-YEAR.

IN SPITE OF THESE SIGNS OF PROGRESS, OUR CRITICS NEVER CEASE TO NOTE THAT WE HAD INITIALLY HOPED TO DO BETTER. WE HAD HOPED TO BRING INTEREST RATES DOWN LAST SPRING INSTEAD OF THIS FALL, AND TO AVOID AN OUTRIGHT RECESSION. UNFORTUNATELY, THE ECONOMY COULD NOT HOLD OUT UNDER THE ACCUMULATING BURDENS OF PAST POLICIES BEYOND THE FIRST QUARTER OF 1981 TO GIVE US TIME TO ACT.

IN ADDITION, OUR PROGRAM WAS SUBJECTED TO A NUMBER OF REVISIONS AND DELAYS IN IMPLEMENTATION. WE MOST CERTAINLY DID NOT GET EVERYTHING WE HAD HOPED FOR.

WE HAD HOPED FOR ABOUT $160 BILLION IN SPENDING REDUCTIONS IN ROUND ONE OF THE ADMINISTRATION'S SPENDING CUTS. WE GOT ABOUT $30 BILLION LESS. WE HAD HOPED TO BRING SPENDING DOWN TO ABOUT 19 PERCENT OF GNP BY 1984. WE MAY HAVE TO POSTPONE THAT A YEAR OR TWO.

We had hoped for a thirty percent personal tax rate reduction starting January 1st at 10 percent a year for three years. We got a bit under 25 percent, on average, with the first installment reduced to 5 percent and delayed until October first. That amounts to only 1.25 percent for tax year 1981, hardly a kick in the pants. In fact, bracket creep and social security tax increases produced a roughly $15 billion personal tax increase for 1981 in spite of the 5 percent cut. The net personal tax rate reduction for calendar 1982 will be only 10 percent instead of 20 percent, and will be roughly offset in dollar terms by bracket creep and social security increases. Only in 1983 and 1984 will the majority of families experience real savings. We have prevented major tax increases. We have not had major tax cuts.

We had hoped for a gradual reduction in money supply growth, from the 8 to 9 percent rates in the Carter years, to a steady 7 percent for 1981, a steady 6 percent for 1982 and so on down to a steady 4 percent for 1984 and beyond. This has not been an easy goal to achieve. M1B growth fell to 4.6 percent for 1981, in an unsteady fashion. After falling by 1* percent per year from October to December 1980, M1B rose at about 13.3 percent per year from December 1980 to April 1981, then fell at nearly 2.9 percent per year from April to July, rose about 2.7 percent per year from July to October, and spurted at 13.7 percent per year from October to early January, 1982.

This uneven pattern, following an unsettling money supply rollercoaster in 1980, kept financial markets nervous. Interest rates fell early in the year, rose to near-record levels again in the spring as money growth accelerated, remained high in the summer, and did not decline substantially until fall as money growth and inflationary expectations slowed over several months.

THUS, THERE IS STILL WORK TO BE DONE.

WE MUST CONTINUE TO RESTRAIN THE GROWTH OF FEDERAL SPENDING TO ENABLE THE ECONOMY TO GROW OUT FROM UNDER THE SPENDING BURDEN. WHETHER FINANCED BY TAXES OR BORROWING, GOVERNMENT SPENDING ABSORBS PHYSICAL AND FINANCIAL RESOURCES BETTER USED FOR PRIVATE SECTOR GROWTH. MANPOWER, FINISHED GOODS AND RAW MATERIALS CONSUMED BY GOVERNMENT ARE URGENTLY NEEDED TO EXPAND AND MODERNIZE THE PRIVATE SECTOR AND TO REWARD WORKERS AND SAVERS FOR THEIR EFFORTS.

WHILE SELECTED TAX INCREASES MAY BE NEEDED TO END INEQUITIES AND TO HELP REDUCE THE DEFICIT, CARE WILL BE TAKEN TO PRESERVE THE SAVING AND GROWTH INCENTIVES EMBODIED IN THE ECONOMIC RECOVERY TAX ACT. HIGHER LEVELS OF PRIVATE SECTOR SAVING, OVER $200 BILLION DOLLARS ANNUALLY BY 1984, WILL HELP TO FINANCE GOVERNMENT AND PRIVATE SECTOR BORROWING NEEDS WITHOUT INFLATIONARY MONEY CREATION BY THE FEDERAL RESERVE. RAPID ECONOMIC GROWTH SPURRED BY THE INVESTMENT AND WORK INCENTIVES WILL YIELD SUBSTANTIAL REVENUE GAINS FROM CURRENT LEVELS AND, BY REDUCING UNEMPLOYMENT AND POVERTY, WILL RELIEVE PRESSURES ON THE FEDERAL BUDGET FOR SAFETY NET SPENDING.

WITH YOUR HELP, AND THE HELP OF THE MILLIONS OF AMERICAN WORKERS, SAVERS, AND ENTERPRENEURS ACROSS THE COUNTRY, WE CAN, AND WE WILL, ACHIEVE THE TWIN ECONOMIC GOALS OF THIS ADMINISTRATION -- STABLE PRICES AND PROSPERITY FOR ALL.

WILL ROGERS ONCE OFFERED SOME ADVICE THAT MAY BE APPROPRIATE HERE. HE SAID, "EVEN IF YOU'RE ON THE RIGHT TRACK, YOU'LL GET RUN OVER IF YOU JUST SIT THERE."

I THINK ALL OF YOU WILL SEE IN THE PRESIDENT'S STATE OF THE UNION MESSAGE AND IN THE FISCAL 1983 BUDGET THE DISTINGUISHING SIGNS OF ECONOMIC LEADERSHIP. YOU WILL ALSO SEE THAT NONE OF US WILL BE SITTING STILL IN 1982.

THE PRESIDENT HAS GIVEN US THE BEST OF BOTH WORLDS, A CLEAR TRACK IN TERMS OF A CONSISTENT ECONOMIC PROGRAM. AND ROOM TO RUN IN TERMS OF INNOVATIVE LEADERSHIP AND THE ABILITY TO EFFECT CHANGE IN HOW THIS GOVERNMENT DOES ITS BUSINESS.

WE HAVE A PROGRAM THAT WILL WORK AND IT'S ONE IN WHICH WE CAN ALL BE CONFIDENT.

THANK YOU.

TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
Wednesday, January 20, 1982

Contact: Willy Carney
(202) 566-5252

McNAMAR CALLS FOR LOWER PAY PRACTICES

In a speech today before the Valve Manufacturers Association, Deputy Treasury Secretary R. T. McNamar called upon private corporate management to reform their inflationary pay practices.

"During 1982, budgets for overall salary increases should be reduced, performance appraisal criteria should be rigorously applied, and that single digit salary increases be substantially below the norms of recent years," said Mr. McNamar.

The Deputy Secretary continued, "Let's be blunt, while organized labor may have priced U.S. products out of some world markets, U.S. management is equally to blame. Many U.S. companies are overstaffed, performance appraisals are too often under-utilized, and management bonuses have been too generous. Now it is time to reverse this trend."

"This type of adjustment in wage inflation is essential to improving the outlook for the long-term productivity increases and renewed real growth," he said.

"Interest rates have fallen since early September," he said. "Unfortunately, in recent weeks we have witnessed renewed growth in the money supply in excess of 12 percent -- a rate that would threaten to rekindle inflation if it continued. Interest rates have temporarily risen in response to that danger. However, I think we can look forward to the basic downward trend in interest rates continuing -- albeit with unfortunate short-term fluctuations, as at present -- as the Fed continues to focus its policy toward achieving slower steady growth in the money supply. Contributing to declining interest rates is an economic slowdown that is worse than we had anticipated and that had reduced loan demand.

"In fact, we are experiencing a recession that will bottom out probably in the spring of 1982. But I'm confident that we'll emerge from it briskly at that time."

R-575

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release January 18, 1982

FACT SHEET

Tax Exemption Bill Summary

The proposed legislation being submitted by the President to the Congress will, for the first time, give the Secretary of the Treasury and the Internal Revenue Service express authority to deny tax-exempt status to private, non-profit educational organizations with racially discriminatory policies. The legislation recognizes and is sensitive to the legitimate special needs of private religious schools.

Section 1 of the bill adds to section 501 of the Internal Revenue Code a new subsection that expressly prohibits granting tax exemptions to private schools with racially discriminatory policies, notwithstanding that such schools otherwise meet the tests for exemption presently listed in section 501(c)(3).

Religious schools of all faiths are permitted to limit, or give preferences and priorities, to members of a particular religious organization or belief in their admissions policies or religious training and worship programs. However, the bill expressly provides that a tax exemption will not be granted if any such policy, program, preference or priority is based upon race or a belief that requires discrimination on the basis of race.

Section 2 of the bill amends several sections of the Internal Revenue Code dealing with deductions to provide, consistent with the exemption provisions of the new law, that no deductions will be allowed for contributions to a school with a racially discriminatory policy.

A BILL

To amend the Internal Revenue Code of 1954 to prohibit the granting of tax-exempt status to organizations maintaining schools with racially discriminatory policies.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DENIAL OF TAX EXEMPTIONS TO ORGANIZATIONS MAINTAINING SCHOOLS WITH RACIALLY DISCRIMINATORY POLICIES.

Section 501 of the Internal Revenue Code of 1954 (relating to exemption from tax) is amended by redesignating subsection (j) as subsection (k) and inserting a new subsection (j) reading as follows:

"(j) ORGANIZATIONS MAINTAINING SCHOOLS WITH RACIALLY DISCRIMINATORY POLICIES. --

"(1) IN GENERAL. -- An organization that normally maintains a regular faculty and curriculum (other than an exclusively religious curriculum) and normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on shall not be deemed to be described in subsection (c)(3), and shall not be exempt from tax under subsection (a), if such organization has a racially discriminatory policy.

"(2) DEFINITIONS. -- For the purposes of this subsection --

"(i) An organization has a 'racially discriminatory policy' if it refuses to admit students of all races to the rights, privileges, programs, and activities generally accorded or made available to students by that organization, or if the organization refuses to administer its educational policies, admissions policies, scholarship and loan programs, athletic programs, or other programs administered by such organization in a manner that does not discriminate on the basis of race. The term 'racially discriminatory policy' does not include an admissions policy of a school, or a program of religious training or worship of a school, that is limited, or grants preferences or priorities, to members of a particular religious organization or belief, <u>provided</u>, that no such policy, program, preference, or priority is based upon race or upon a belief that requires discrimination on the basis of race.

"(ii) The term 'race' shall include color or national origin."

SEC. 2. DENIAL OF DEDUCTIONS FOR CONTRIBUTIONS TO ORGANIZATIONS MAINTAINING SCHOOLS WITH RACIALLY DISCRIMINATORY POLICIES.

(a) Section 170 of the Internal Revenue Code of 1954 (relating to allowance of deductions for certain charitable, etc., contributions and gifts) is amended by adding at the end of subsection (f) a new paragraph (7) reading as follows:

"(7) DENIAL OF DEDUCTIONS FOR CONTRIBUTIONS TO ORGANIZATIONS MAINTAINING SCHOOLS WITH RACIALLY DISCRIMINATORY POLICIES. -- No deduction shall be allowed under this section for any contribution to or for the use of an organization described in section 501(j)(1) that has a racially discriminatory policy as defined in section 501(j)(2)."

(b) Section 642 of such Code (relating to special rules for credits and deductions) is amended by adding at the end of subsection (c) a new paragraph (7) reading as follows:

"(7) DENIAL OF DEDUCTIONS FOR CONTRIBUTIONS TO ORGANIZATIONS MAINTAINING SCHOOLS WITH RACIALLY DISCRIMINATORY POLICIES. -- No deduction shall be allowed under this section for any contribution to or for the use of an organization described in section 501(j)(1) that has a racially discriminatory policy as defined in section 501(j)(2)."

(c) Section 2055 of such Code (relating to the allowance f estate tax deductions for transfers for public, charitable, nd religious uses) is amended by adding at the end of subsecion (e) a new paragraph (4) reading as follows:

"(4) No deduction shall be allowed under this section for any transfer to or for the use of an organization described in section 501(j)(1) that has a racially discriminatory policy as defined in section 501(j)(2)."

(d) Section 2522 of such Code (relating to charitable and imilar gifts) is amended by adding at the end of subsection (c) new paragraph (3) reading as follows:

"(3) No deduction shall be allowed under this section for any gift to or for the use or an organization described in section 501(j)(1) that has a racially discriminatory policy as defined in section 501(j)(2)."

EC. 4. EFFECTIVE DATE.

The amendments made by this Act shall apply after July 9, 970.

Office of the Press Secretary

For Immediate Release January 18, 1982

TEXT OF LETTER SENT TO
THE PRESIDENT OF THE SENATE AND
THE SPEAKER OF THE HOUSE

Dear Mr. President/Mr. Speaker:

As you are aware, the Department of the Treasury announced on January 8 that the Internal Revenue Service would no longer deny tax-exempt status to private, non-profit educational organizations that engage in racially discriminatory practices but otherwise qualify for such status under the present Internal Revenue Code. That decision reflects my belief that agencies such as the IRS should not be permitted, even with the best of intentions and to further goals that I strongly endorse, to govern by administrative fiat by exercising powers that the Constitution assigns to the Congress.

I share with you and your colleagues an unalterable opposition to racial discrimination in any form. Such practices are repugnant to all that our Nation and its citizens hold dear, and I believe this repugnance should be plainly reflected in our laws. To that end, I am herewith submitting to the Congress proposed legislation that would prohibit tax exemptions for any schools that discriminate on the basis of race. This proposed legislation is sensitive to the legitimate special needs of private religious schools.

I pledge my fullest cooperation in working with you to enact such legislation as rapidly as possible, and urge that you give this matter the very highest priority.

I have been advised by the Secretary of the Treasury that he will not act on any applications for tax exemptions filed in response to the IRS policy announced on January 8, until the Congress has acted on this proposed legislation.

I believe the course I have outlined is the one most consistent both with our mutual determination to eradicate all vestiges of racial discrimination in American society, and with a proper view of the powers vested in the Congress under our constitutional system.

I feel this legislative action is important to and desired by all citizens of this great Nation; I am confident that you will give this issue the prompt attention it deserves.

Sincerely,

/s/ Ronald Reagan

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TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
Monday, January 18, 1982

Contact: Marlin Fitzwater
(202) 566-5252

TREASURY - IRS TO HOLD ACTION ON TAX EXEMPTIONS

Recognizing the President's desire to have legislation introduced to prohibit the granting of tax exemptions to certain educational institutions that engage in racially discriminatory practices, the Secretary of Treasury has instructed the Commissioner of Internal Revenue not to act on any applications for tax exemptions filed in response to the Internal Revenue Service's policy announced on Friday, January 8, 1982, until Congress has acted on the proposed legislation (except as required by the memorandum in support of the motion to vacate as filed in the Supreme Court on January 8, 1982).

XXX

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
Wednesday, January 20, 1982

REMARKS PREPARED FOR DELIVERY BY
THE HONORABLE R. T. MCNAMAR
DEPUTY SECRETARY OF THE TREASURY
TO THE VALVE MANUFACTURER'S ASSOCIATION
WASHINGTON, DC
WEDNESDAY, JANUARY 20, 1982

Good Morning. It's a pleasure to be here.

I want to discuss with you the President's program, the current status of the economy, the economic agenda for 1982, and the outlook for the future.

On this first anniversary of Ronald Reagan's inauguration as President, it is appropriate to remember his challenge: "If not now, when; if not us, who?"

Against this standard, let me begin by saying that, while we are in a hurry, the President's program is not one of quick fixes, short-term solutions, or impulsive reactions to transitory phenomena. It is a long-term program for the future to change some long-term trends we inherited from the past.

The program has three specific goals.

1. To minimize inflation;
2. To reduce the rate of growth of government spending;
3. To restore stable, real economic growth.

We did not attain these goals in our first year -- nor will we fully attain them in our second.

But I would suggest that since the President's inauguration we have begun some fundamental changes in direction -- beginning a reversal of trends that have been developing for forty years. And I believe historians will record that we have just passed an inflection point in our economic history.

Let's quickly review some of that recent history.

R-576

The Problem

Specifically, let's examine the legacy of rapid and inconsistent monetary growth, stop-and-go fiscal policies and the constant growth in federal revenue caused by inflation and a counterproductive corporate and personal tax system.

The inflation rate almost tripled in four years to over 12 percent in 1980, before falling slightly last year. Federal spending rose from $270 billion in 1974 to $660 billion in FY 81 and claims 23 percent of GNP--almost one dollar in every four.

Unfortunately, during this period not all the trends were rising. Productivity, for example, has long been in a major decline. The rate of productivity growth decreased from an annual average of 3.1 percent in the 20-year period after World War II to 0.7 percent in the 1973-80 period. And American jobs and investment went overseas as a result.

Real GNP growth, after averaging 4.2 percent in the 1960's, dropped to 3.2 percent in the 1970's, and plunged to minus 0.2 percent in 1980.

At the same time, the personal savings rate -- which averaged 7.7 percent in the 10 years ending in 1975 fell almost to the 4.5 percent rate early in 1981 and, in the mid-quarter of 1981 was a low 5.2 percent.

Granted, the economic situation that this Administration is trying to rectify is due to bipartisan errors. The basic weaknesses in our economy have been developing over a period of three or four decades -- a period during which both Republicans and Democrats have occupied the White House, and a spending oriented Congress piled Federal spending commitment on top of commitment. Unfortunately, yesterday's spending commitments have become today's overdue bills.

My message is this: on taking office, the Reagan Administration inherited an economic situation that could be described as dismal.

Frankly, this is a mess that was so long in the making that it will be more than days, or weeks, or months, in the mending. But what we are trying to do is to re-define the relationship between the public and the private sectors and -- for a change -- redefine it in favor of private initiative and private enterprise. In short, we want to establish a long-term framework for the future of our economy.

The President's Program for Economic Recovery

Let me briefly summarize the program at this point, then give you some idea of its current status and of the outlook for the future.

The program is composed of four carefully integrated parts which, if consistently implemented by Congress will ameliorate inflation, reduce the size of the federal government and restore the kind of real economic growth that will benefit everyone -- investor and industrialist, consumer and corporation, hard hat and housewife.

The first element of the program is a non-inflationary monetary policy. We firmly believe that only a slow, steady consistent growth in the money supply will restore financial market confidence in the Federal Reserve, reduce inflation and over the long-term set a trend for lower interest rates that reflect lower inflationary expectations.

Second, there's the tax program. Let's look at some of its highlights.

For individuals, it offsets inflationary tax increases and the disincentives of rising marginal tax rates with a cumulative tax cut of 25 percent across the board. The act immediately reduces the top marginal rate for investment income from 70 percent to 50 percent. Both are precisely the right tax policies both for the long-term and for the recession we are now passing through.

These tax provisions are important changes for individuals, but at least as dramatic are the new provisions for business. Specifically, the Act establishes an accelerated capital recovery system that virtually eliminates the erosion through inflation of the value of the old depreciation allowances.

In fact, we've effectively eliminated the tax on income from new investment in plant and equipment. We've also greatly expanded the opportunities for leasing plant and equipment by making it possible to transfer some tax benefits, thus helping companies--particularly new ones--with little or no earnings to take advantage of the program's incentives.

On the subject of leasing, most of the public comments have been focused on the benefits from leasing to a few large, established companies experiencing losses in depressed industries. By contrast, we view these provisions as credit indifferent. In fact, we think that -- as the leasing market develops -- these provisions will become increasingly important to a broad range of industries, including your own.

Third, let's talk about federal regulations. For decades the business community has been insisting that excessive regulation stifles capital investment, protects the inefficient, and exacts unwarranted costs for minimal benefits.

Early in his Administration, the President appointed Vice President Bush to head a task force on regulatory reform. By mid-summer, over seven hundred regulations had been reviewed, and that review continues unabated.

Fourth, and finally, we want to slow the growth of the federal spending and actually reduce government's size as a proportion of the Gross National Product. In this way we can free real resources for the private sector -- capital that can be used to modernize and expand the productive elements of our society.

What's more, curbing the growth of federal spending now and in the future reduces competition for credit and alleviates pressure on the Federal Reserve to monetize the deficit and therefore contribute to inflation.

Results of the Program

In varying degrees, elements of the program are in effect today. Although too erratic, the growth in the monetary aggregates has certainly been slowed.

The first stage of the tax program became effective on October first. The essence of the Administration's tax program is to restore incentives and to cap revenues flowing into Washington from an "Inflation Dividend."

In 1982 alone, business tax reductions will total more than $10 billion. That amounts to a $10 billion increase in business cash flow -- $10 billion that should be invested in productive ventures.

In 1983 the tax reduction act could conceivably reduce the need for business borrowing by $20 billion -- that's $20 billion more that will be available for investment, that won't have to be borrowed by private companies. Meanwhile, personal savings will increase, adding several tens of billions of dollars to the credit markets.

The third element of the program -- regulatory reform -- has already eliminated numerous major Federal regulations. The Federal Register was 25 percent smaller in 1981 than in 1980. The result is an initial saving to the economy of $16 billion, plus a recurring, annual saving estimated at $6 billion. Again that's cash that corporate borrowers won't be coming to market to seek.

And we have succeeded in initiating a period of budgetary discipline. Last summer Congress agreed to cuts in the fiscal 1982 budget amounting to $35 billion. From 1982 to 1984 the cumulative cuts then enacted will amount to $130 billion. More recently, an additional $4 billion has been shaved from 1982 outlays. Additional cuts of major proportions will be proposed in the forthcoming budget.

That's sound progress. It's an indication that the Administration and the Congress are moving in the right direction. But there can be no question that more cuts are needed.

Nor should anyone question our resolve to go back to the Hill again and again for more cuts in Federal spending, for more cuts in entitlement programs, and for a workable, bipartisan reform of the Social Security program. That's a sine qua non to long-term success.

In 1981 we've redefined and shifted the terms of debate and policy deliberation. The road to fiscal responsibility will be long and arduous, but the objective is clear. We'll pick our times, we'll lose some battles, but eventually the economic war will be won.

Current State of the Economy

In fact, we now have some rather dramatic evidence that major battles in the war are being won. Take interest rates, for example. Since Labor Day, short term interest rates have dropped by several percentage points, while longer term rates have retreated by about one percentage point.

Major progress has been made on the inflation front, as well. Producer price increases, for example, peaked early in 1980, and have fallen dramatically since early this year.

Producer Prices
Annualized Rate of Increase

	Full Yr. 1980	Full Yr. 1981	Three Months Ending Dec. 1981
Finished Goods	11.7%	7.0%	5.4%
Intermediate Goods	12.6%	6.1%	2.5%

Equally important, we have recently witnessed the first decline in the rate of wage inflation in a number of years. From a high of 9.3 percent in 1980, the hourly earnings index for production work hours slowed to an 8.9 percent rate in the first half of 1981. A further drop to 7.5 percent in the second half of last year culminated in an increase of only 0.1 percent last month.

While inflation and interest rates have been declining, there can be no doubt that the economy is performing poorly, and worse than we had expected. Two flat or mildly negative quarters last year were anticipated in our original estimates.

However, the current downturn will be worse than envisioned in our earlier scenarios. You can attribute that to two things: first, delay on the timing of our proposed tax cut and the delay in its passage; and, second, interest rates that stayed high longer than expected.

None of this constitutes sufficient reason to change the program materially. It only adds to the case for trimming the budget even further.

What's needed -- as I suggested earlier -- is time. Admittedly this will try the American political will during a recession this winter and during an election year.

As Henry Kissinger said of the American lack of patience: "Americans seem to have a proclivity to pull up the trees every few weeks to see if the roots are really growing."

Deficits

Probably the greatest single stimulus for pulling up the trees to check the roots is a concern in many quarters about the projected deficits. There's no question in anyone's mind that the outlook for the anticipated Federal deficits has deteriorated sharply from the projections that we made in late spring, in part due to the recession's being more severe than expected.

Ironically, the second major reason the deficits will be temporarily higher than expected is because of the progress that has been made in fighting inflation.

Think about it. Due to the way in which most entitlement programs are indexed, Federal spending or outlays are linked to the previous year's inflation rate, but revenues based on taxable income are basically linked to the current year's inflation rate.

All other things being equal, the faster inflation comes down, the more difficult it becomes to quickly balance the budget. No administration has faced this phenomenon of a sustained decline in inflation since our major entitlements programs were indexed.

The circular equation is fairly simple. Inflation-indexed programs increase federal outlays--the Treasury borrows to meet the entitlement obligation--the Fed buys the Treasury's debt--the money supply increases too rapidly causing inflation--the inflation causes indexed programs to increase federal outlays and so on. This vicious circle must be broken, because inflation is the largest, most regressive tax of all.

And the circle must be broken by attacking its fundamental cause, the overall level and rate of growth in government spending--a 16 percent rate of growth in recent years.

That is what we are determined to do. We are not going to engage in more futile rounds of trying to raise taxes faster than Congress can raise spending. That route has been tried and has failed. We are going to cut spending.

Deficits are a part of the transformation process. But they are not something this Administration takes lightly, and they are not something we intend to live with permanently.

The Policy Agenda for 1982

Just as these economic issues shaped the policy agenda for 1981, they will continue to shape the Administration's agenda -- the policy debate -- for 1982.

Many of those special interests that both fostered the growth of and derived ever-greater benefit from the Federal government, have been declaring the President's economic program a failure since before it was unveiled. And though they suffered defeat in every major battle last year, they will undoubtedly try to unravel that program this year. Hence, much of the policy agenda will be aimed toward preserving last year's gains.

Most important, we must be prepared to meet attacks on the program's key incentive-oriented tax provisions. Those attacks will not be aimed directly at the core provisions that take effect this year or perhaps next. Rather the attacks will be aimed at what some critics perceive to be the weak periphery.

Some will seek to delay, reduce or eliminate the third personal tax reduction -- a 10 percent reduction that becomes effective July 1, 1983. Others may seek to eliminate the indexing provision. Still others will seek to repeal the safe-harbor leasing provisions of last year's tax act. All these attempts will be shrouded in specious arguments of "sound fiscal policy," reduced "corporate welfare," and "lower interest rates."

Contrary to the claims that will be made, these tax provisions are not peripheral. In fact, they are central to our efforts to restore long-term incentives to save, invest, and work.

While there undoubtedly will be some modest increases in taxes in 1983 and 1984, they will not be of a type that will destroy the incentive effects of our long-term program. We will continue to focus on reducing government spending, on reducing government intervention in the economy by eliminating unwarranted regulations, and on continuing to reduce inflation by maintaining a slow, steady growth of the money supply. In short, we want to increase the long-term return on investment for work, capital, and savings.

The Management Agenda for 1982

Our policy agenda, we hope, will also help shape your management agenda this year.

Managerially, the key to the nation's economic recovery is not what we in the Government do; it's what you in business do in response to the restored economic incentives that were enacted last year.

How well, for example, you learn about and take full advantage of the investment incentives provided in the tax reduction act--will determine whether or not our country will again enjoy high real growth and rapid rates of improvement in productivity.

Similarly, how well management and labor respond to an improved outlook for inflation will determine whether we lock in lower rates of inflation for the long term or not.

In recent years, wage settlements have been ever larger as both blue and white collar workers attempted to catch-up with a constantly rising inflation rate.

Inflation is no longer rising. It is falling--and falling rapidly. Nevertheless, we are living with a deeply rooted inflationary psychology that is difficult to change. Think about our current legacy. Half the working population today has never known price stability or low inflation in their adult lives. Fundamental attitudes born of such experience will die slowly, yet they must yield to changed realities.

Inflation now is coming down rapidly and will continue to decline. If wage settlements do not follow suit, company profits will be squeezed out of existence in the middle. With those vanishing profits will go the renewed investment in plant and equipment that would restore real growth and create more jobs -- more highly productive jobs -- the kind that allow both American business and American labor to succeed in a much more competitive world economy.

Lower nominal wage settlements are thus a logical result of lower inflation expectations. It is important that management and labor -- union and non-union alike--take these new realities into account in 1982. There are, as you know, a number of encouraging signs that this may be happening.

As most of you know from reading the newspapers, there has been a variety of reports about wage concessions from, among others, the United Auto Workers', the meat packers', and the machinists' unions. They've either reopened existing contracts, eliminated previous pay practices, or settled for substantially lower pay increases. This does reflect the new reality of American economics.

However, equally important -- if not more so -- are management's pay practices in the non-unionized sector, particularly regarding white collar workers. And here, too, one would anticipate that, during 1982, budgets for overall salary increases should be reduced, performance appraisal criteria should be more rigorously applied, and that single digit salary increases would be substantially below the norms of recent years. Again, in the auto industry, for example, this pattern appears to be unfolding for white collar management as well. Let's be blunt, while organized labor may have priced U.S. products out of some world markets, U.S. management is equally to blame. Many U.S. companies are over-staffed, performance appraisals are too often under-utilized, and management bonuses have been too generous. Now it is time to reverse this trend.

This type of adjustment in wage inflation is essential to improving the outlook for long-term productivity increases and renewed real growth.

The Outlook

How realistic is that outlook?

As I noted earlier, interest rates have fallen since early September. Unfortunately, in recent weeks we have witnessed renewed growth in the money supply in excess of 12 percent--a rate that would threaten to rekindle inflation if it continued. Interest rates have temporarily risen in response to that danger. However, I think we can look forward to the basic downward trend in interest rates continuing--albeit with unfortunate short-term fluctuations, as at present--as the Fed continues to focus its policy toward achieving slower steady growth in the money supply. Contributing to declining interest rates is an economic slowdown that is worse than we had anticipated and that has reduced loan demand.

In fact, we are experiencing a recession that will bottom out probably in the spring of 1982. But I'm confident that we'll emerge from it briskly at that time.

In addition to lower interest rates that should begin to help such sensitive areas as autos and housing, a 5 percent tax cut became effective October first. Another 10 percent cut in personal rates will occur on July 1, and the business tax provisions should be worth over $10 billion in fiscal 1982, as well.

These tax reductions will do more than spur consumption demand. They'll increase cash flow or capital, adding to both individual and corporate ability and incentive to save. Remember, investment spending is spending too, and the wages paid in the investment goods industries will contribute to further saving and consumption spending.

The real question is: What will happen as the recession ends? Will we face another round in the cycle of "stagflation" or will we emerge into a new era of noninflationary growth?

The answer to that question depends on how resolute we and the Congress are; and it depends on the response of management and labor to the incentives in the economic program. As I suggested earlier, we -- the Reagan Administration -- fully intend to stay the course.

We intend to succeed and I believe that you have a stake in that success. And I'm asking you to join us by making sure that Congress knows the views of you and your employees. They're politicians; they count the post cards and phone calls, then vote. If you haven't participated you'll be ignored.

If together we can once again place limits on the growth of government, we will emerge into an era of positive real returns marked by a willingness to hold productive assets -- a decade when confidence in the long-term will supplant expedience for the short-term. In short, we will emerge into an era of prosperity.

Thank you.

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FOR RELEASE AFTER 1:00 P.M.
Wednesday, January 20, 1982

REMARKS PREPARED FOR DELIVERY BY
THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY
TO
THE MUNICIPAL FINANCE OFFICERS ASSOCIATION
AT THE CAPITAL HILTON
WASHINGTON, D.C.
WEDNESDAY, JANUARY 20, 1982

I know these are difficult times for Municipal Finance Officers.

Many of you face added responsibilities, and need to find the resources with which to meet those responsibilities. It's a situation that is -- in a word -- problematical.

It's similar to the fellow who loved to play baseball. One day his mind took a theological turn, and he began to speculate on sports activities in heaven.

He decided to investigate further by going to a medium. The medium revealed a vision that would delight any baseball fan. He saw baseball diamonds all over heaven, as well as the best equipment. It seemed that baseball was the celestial pastime; it was played everyday.

He was overjoyed with the vision. But then the medium said there was also some bad news. "What could that be," he said. "Well," said the medium, "You're scheduled to pitch next Wednesday."

Local and state officials welcome the return of authority that this Administration is effecting. But -- as in the case of our baseball devotee -- the blessing is not unmixed.

State and local governments are feeling the pressure of federal budget cuts, while changes in federal tax policy are adding to the strains on state and local governments. In many parts of the country, those cuts have been exacerbated by the recession.

We are aware of the situation in which local governments find themselves. And, though we firmly believe that national tax and budget policies should primarily address national priorities, we are certainly mindful of the federal responsibility to weigh the consequences for state and local governments in our deliberations.

With that in mind, I would like to briefly outline our present course for national economic recovery.

After the heady legislative successes of last summer, it is hard to bear the doubts, criticism and signs of impatience over the current state of the economy and the economic program that seem to be arising from all quarters. Let me assure you that the economic program is on track, and that the economy will be on track very soon.

Our program is long-term and comprehensive; and it has barely begun. The first and smallest round of tax cuts has been in effect less than 90 days, other cuts phased in 20 days ago and truly significant cuts will begin next summer.

To say our policies aren't working is like saying -- while the opening kick-off is still in the air -- that the Redskins are behind. In the last few months, inflation has come down. Interest rates are down; and there is already an improvement in the rate of personal savings. Wait until the market place really catches those tax incentives and starts to run, before passing judgement on which way the game is going.

The economic mess that we inherited could hardly have been worse. And it is going to take some time to turn this thing around. Not only were all the major economic trends getting worse, but the previous Administration had no plans for coping. We came in with a clear picture of the causes of the trouble and a clear program designed to set things straight.

The economy in 1980 was staggering under a long series of ineffective stop and go policies which had produced four years of rising inflation, rising interest rates, rising tax rates, and rising Federal spending as a share of GNP. Only the good things were falling -- things like real take-home pay and productivity. After two years of double digit inflation and interest rates, and sharply higher tax rates since the last tax cut in 1978, the economy was on the brink. Autos and homebuilding were collapsing. Credit controls were the last straw, triggering the sharp collapse which became the recession of 1980.

After controls ended, the economy struggled to recover, growing through the first quarter of 1981. But the causes of the recession were not corrected, and there was a renewed slump. The causes were the same: continued high inflation and interest rates, and rising tax rates. By the spring of 1981, autos had been totalled and construction was at a standstill. Industrial production was practically flat from March to July. By July, it was falling.

Let me repeat. <u>By spring it was flat</u>. <u>By July it was falling</u>. <u>Before the tax bill took effect</u>. <u>Before the major budget cuts</u>. <u>Before the Reagan program</u>.

Those who blame Reaganomics for the current slump must believe in retroactive causation, and that the economy, like Merlin, magically lives backwards in time!

We inherited this mess. But we understand its causes. To correct the errors of the past, and to restore economic growth and full employment while reducing inflation, a four part program was created. It consists of:

1. Slowing the growth of federal spending. This is not an ideological goal. It is a necessary step to return the real and financial resources now being absorbed by the government to the private sector, where it can be used for investment and growth.

2. An incentive tax policy. This is not a random tax cut to give away money -- only to have the government borrow it back. It is a carefully structured tax cut to raise the rewards for each hour worked and each dollar saved, to encourage people for supply more effort, more saving and more investment to the economy.

3. A non-inflationary monetary policy, designed to end inflation and reduce the high interest rates and rising tax rates that inflation produces.

4. Regulatory reform, to reduce the inefficiencies and enormous costs that are holding back production and raising prices.

Large parts of our program are in place.

We have achieved substantial reduction in the growth of federal spending. Spending had been rising at 13 percent per year under the Carter budgets through FY 1981, rising from 21.6 percent of GNP in FY 77 when President Ford left office to a record 23.1 percent in FY 81. The spending reductions already enacted and those still to be proposed, coupled with faster economic growth, will bring us closer to our long term goals of 19 to 20 percent of GNP in the years ahead.

The Economic Recovery Tax Act of 1981 is in place. The accelerated cost recovery system increases the investment tax credit, and shortens and simplifies the depreciation schedules. It will restore a reasonable rate of return on investment in plant and equipment. For the first time in years, firms will be allowed a tax write off large enough to let them replace their plant and equipment, the costs of which have been rising sharply with inflation.

Personal tax rate reductions of nearly 25 percent over three years will keep workers and savers ahead of bracket creep, until the tax code is finally indexed in 1985. Under the three year incentive tax rate reduction, after tax wages, interest and dividends will rise. The cost of hiring and borrowing will fall.

The bracket creep which had discouraged U.S. labor, and priced it increasingly out of world markets, is at an end. The rising marginal tax rates which, with inflation, have cut personal savings rates in all brackets almost in half between 1975 and 1980, will be reduced. Discriminatory tax rates on income from saving have been ended, and the marriage penalty has been reduced.

Regulatory reform is under way, directed by the Vice President's regulatory task force.

Monetary policy has shifted toward reducing inflation. We have encouraged The Federal Reserve to keep money growth at levels consistent with a gradual return to stable prices.

These policies are just beginning. It will take time for them to work. The public understands this. Polls indicate that the people believe the economic recovery program will turn the economy around, and that they are willing to give it time to work.

In fact, there are signs of progress already:

Consumer prices, which rose 12.4 percent during 1980, are likely to finish 1981 just over 9 percent, and continue to slow in the months ahead.

Producer prices, which rose 11.8 percent during 1980, rose only 7.0 percent in 1981, and indicate continued moderation at the consumer level.

Interest rates, driven by inflation, reached record highs in the last two years, but have since fallen. The prime rate was 21-1/2 percent a year ago, and is now at 15.75. Treasury bills were over 15.5 percent a year ago, and are now under 12.5.

As the next round of tax rate reductions take effect in July, and as firms begin to take advantage of investment opportunities opened up by the new tax bill, a strong recovery is likely by mid-year.

In spite of these signs of progress, our critics never cease to note that we had initially hoped to do better. We had hoped to bring interest rates down last spring instead of this fall, and to avoid an outright recession. Unfortunately, the economy could not hold out under the accumulating burdens of past policies beyond the first quarter of 1981 to give us time to act.

In addition, our program was subjected to a number of revisions and delays in implementation. We most certainly did not get everything we had hoped for.

We had hoped for about $160 billion in spending reductions in round one of the Administration's spending cuts. We got about

$30 billion less. We had hoped to bring spending down to about 19 percent of GNP by 1984. We may have to postpone that a year or two.

We had hoped for a thirty percent personal tax rate reduction starting January 1st at 10 percent a year for three years. We got a bit under 25 percent, on average, with the first installment reduced to 5 percent and delayed until October first. That amounts to only 1.25 percent for tax year 1981, hardly a kick in the pants. In fact, bracket creep and social security tax increases produced a roughly $15 billion personal tax increase for 1981 in spite of the 5 percent cut. The net personal tax rate reduction for calendar 1982 will be only 10 percent instead of 20 percent, and will be roughly offset in dollar terms by bracket creep and social security increases. Only in 1983 and 1984 will the majority of families experience real savings. We have prevented major tax increases. We have not had major tax cuts.

We had hoped for a gradual reduction in money supply growth, from the 8 to 9 percent rates in the Carter years, to a steady 7 percent for 1981, a steady 6 percent for 1982 and so on down to a steady 4 percent for 1984 and beyond. This has not been an easy goal to achieve. M1B growth fell to 4.6 percent for 1981, in an unsteady fashion. After falling by 1 percent per year from October to December 1980, M1B rose at about 13.3 percent per year from December 1980 to April 1981, then fell at nearly 2.9 percent per year from April to July, rose about 2.7 percent per year from July to October, and spurted at 13.7 percent per year from October to early January, 1982.

This uneven pattern, following an unsettling money supply rollercoaster in 1980, kept financial markets nervous. Interest rates fell early in the year, rose to near-record levels again in the spring as money growth accelerated, remained high in the summer, and did not decline substantially until fall as money growth and inflationary expectations slowed over several months.

Thus, there is still work to be done.

We must continue to restrain the growth of Federal spending to enable the economy to grow out from under the spending burden. Whether financed by taxes or borrowing, government spending absorbs physical and financial resources better used for private sector growth. Manpower, finished goods and raw materials consumed by government are urgently needed to expand and modernize the private sector and to reward workers and savers for their efforts.

While selected tax increases may be needed to end inequities and to help reduce the deficit, care will be taken to preserve the saving and growth incentives embodied in the Economic Recovery Tax Act. Higher levels of private sector saving, over $200 billion dollars annually by 1984, will help to finance government and private sector borrowing needs without inflationary money creation by the Federal Reserve. Rapid economic growth spurred by the investment and work incentives will yield substantial revenue gains from current levels and, by reducing unemployment and poverty, will relieve pressures on the federal budget for safety net spending.

With your help, and the help of the millions of American workers, savers, and enterpreneurs across the country, we can, and we will, achieve the twin economic goals of this Administration -- stable prices and prosperity for all.

Will Rogers once offered some advice that may be appropriate here. He said, "Even if you're on the right track, you'll get run over if you just sit there."

I think all of you will see in the President's State of the Union Message and in the Fiscal 1983 budget the distinguishing signs of economic leadership. You will also see that none of us will be sitting still in 1982.

Certainly, success will not come overnight. There will be short term problems. Nevertheless, long term economic improvement and greater flexibility will mean major benefits to state and local governments.

We are now making decisions about revenue turnbacks and fiscal 1983 funding for the revenue sharing program -- issues of profound importance to state and local governments.

I'm here to ask for your cooperation in that policy process, and also for your commitment to President Reagan's program for economic recovery.

Thank you.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE January 20, 1982

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $5,252 million of $ 12,018 million of tenders received from the public for the 2-year notes, Series N-1984, auctioned today. The notes will be issued February 1, 1982, and mature January 31, 1984.

The interest coupon rate on the notes will be 15% The range of accepted competitive bids, and the corresponding prices at the 15% coupon rate are as follows:

	Bids	Prices
Lowest yield	14.95%	100.084
Highest yield	15.11%	99.816
Average yield	15.08%	99.866

Tenders at the high yield were allotted 81%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 102,370	$ 72,070
New York	9,765,725	4,105,715
Philadelphia	81,000	48,000
Cleveland	192,305	107,305
Richmond	170,835	114,410
Atlanta	130,660	116,660
Chicago	821,290	208,815
St. Louis	177,445	170,255
Minneapolis	61,635	60,635
Kansas City	121,530	119,485
Dallas	61,750	55,800
San Francisco	324,350	65,310
Treasury	7,095	7,095
Totals	$12,017,990	$5,251,555

The $5,252 million of accepted tenders includes $1,397 million of noncompetitive tenders and $3,330 million of competitive tenders from private investors. It also includes $525 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 $5,252 million of tenders accepted in the auction process, $490 million of tenders were accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities, and $302 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

R-579

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE January 21, 1982

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $5,251 million of 52-week bills to be issued January 28, 1982, and to mature January 27, 1983, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-issue Yield) 1/
High -	86.841	13.014%	14.66%
Low -	86.663	13.190%	14.88%
Average -	86.711	13.143%	14.82%

Tenders at the low price were allotted 77%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 42,450	$ 32,450
New York	8,659,740	4,474,690
Philadelphia	35,675	10,675
Cleveland	103,800	67,625
Richmond	51,010	37,550
Atlanta	65,735	60,735
Chicago	774,790	198,675
St. Louis	51,650	39,440
Minneapolis	39,860	36,850
Kansas City	58,895	58,895
Dallas	16,000	16,000
San Francisco	494,285	164,785
Treasury	52,235	52,235
TOTALS	$10,446,125	$5,250,605
Type		
Competitive	$ 8,783,720	$3,588,200
Noncompetitive	537,405	537,405
Subtotal, Public	$ 9,321,125	$4,125,605
Federal Reserve	800,000	800,000
Foreign Official Institutions	325,000	325,000
TOTALS	$10,446,125	$5,250,605

1/ The average annual investment yield is 15.37%. This requires an annual investment yield on All-Savers Certificates of 10.76%.

R-579

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

REMARKS PREPARED FOR DELIVERY BY

THE HONORABLE ROGER W. MEHLE

ASSISTANT SECRETARY OF THE TREASURY, DOMESTIC FINANCE

BEFORE THE SECURITIES INDUSTRY ASSOCIATION'S 1982 TRENDS CONFERENCE

NEW YORK CITY

JANUARY 20, 1982

This morning I would like to share with you some of the Administration's views on potential legislative and regulatory changes in the depository institutions industry that will also affect you as important members of our financial services industry. The Administration's support of these changes indicates our commitment to the free market system and our determination to shape current legislation and regulation to reflect market reality. It also furthers our goal of giving depository institutions the flexibility that you already have to meet the changing needs of the market place.

Most of you are aware of the players in the financial services industry, and of the range of services they offer, but let me reintroduce a few of them to you to show how much change has already taken place.

Your competitors -- the money center banks -- offer municipal bond underwriting, corporate financial planning, business loans, credit cards, check cashing, consumer finance, travel planning nationwide, and loans in most states and mortgages in some locations.

Your competitor Manufactures Hanover of New York recently bought a string of 67 finance offices in California, Oregon and Washington.

Your competitor and one of your own number, Merrill Lynch, offers mortgages, check-writing, trust and estate planning and money management.

Your "unregulated" competitors have greater flexibility. Your competitor Sears has long offered insurance and consumer credit. It has recently acquired the nation's fifth largest brokerage firm, decided to establish a money market fund, and purchased the nation's largest real estate brokerge firm. It is also the largest savings and loan holding company in the United States. Its announced intent is to become "the largest consumer oriented financial service entity."

Your competitor American Express offers credit cards, cable television, securities brokerage, traveller's checks and travel planning (as well as airport cash).

Your competitor General Electric is involved in real estate loans, second mortgages, commercial real estate financing, mortgage insurance and leveraged leasing.

A journalist recently compared the state of financial services today with the grocery business of the 1920's and 1930's. Fifty years ago, butchers sold meat, green grocers sold produce, drugstores sold medicines, and other shops sold sundries. The advent of the supermarket put many of these single-service shops out of business, and substantially changed the way the remainder conducted their operations.

A recent private study found perhaps an interesting parallel. The average consumer now uses over 30 financial services per year, and goes to more than a dozen financial institutions to obtain them. We are witnessing today a change in this environment, and as illustrated by my recitation of your competitors, the emergence of supermarkets in the financial services industry.

Of course, implicit in all these "supermarket" strategies is the recognition of the convenience of one-stop shopping and the importance of customer contact.

I am not predicting the demise of specialized financial institutions; financial services are not cabbages, and the customer's need for specialized, individual assistance for his financial affairs will remain. A market for specialized institutions will exist. However, financial institutions that wish to specialize should do so by choice; they should not specialize because they are required to do so by government regulation.

Yet for the last half-century, that's exactly what we've done. Government erected seemingly countless barriers to keep the lettuce from spilling over into the tomato bin, and to keep California tomatoes from being sold in Florida and vice versa.

Banks were forbidden to take deposits across state lines. Investment banks were separated from commercial banks and forbidden to take deposits at all. Special sources of funds, for example savings and loan deposits, were reserved to special uses, such as housing. These restrictions arose from a number of motivations, most, if not all, worthy.

Many of the laws and regulations that arose from these motivations were conceived at the time of their enactment to be permanent solutions too perceived problems -- Glass-Steagall, for example.

Others, such as the interest differential on thrift deposits, were to be temporary expedients until transient phenomena passed. You may remember that thrifts were first brought under interest rate restrictions and given authority to pay more for deposits than commercial banks in 1966. At that time market interest rates were rising and thrifts could not compete for deposits. Congress, in order to protect saving and loan associations and mutual savings banks, voted to temporarily bring thrifts under interest rate ceilings for a one-year period -- that "temporary assistance" has lasted for over 15 years.

These legal and regulatory barriers are obviously breaking down today, however. Some have already fallen. Many others are crumbling under the weight of economic and technological change.

The change from an economic environment of stable and low rates of inflation and interest to one of high and volatile rates has obviously motivated profound changes. The old strategy of borrowing short from small savers and lending long to homebuyers was a sure formula for success under the former stable interest rate environment. But, it's a blueprint for disaster now.

And how about technological change? The computer, telecommunications and the melding of the two have made possible the integrated marketing of mutual funds, credit cards, bill paying and other services of today's Cash Management Account.

In the future, thanks to cable television, satellites, and the telephone, the consumer will not even have to go to the bank. He will do his banking from his home or place of business. Indeed, not just his banking, but all of his financial business, including stocks, bonds and insurance.

The old days of brick-and-mortar banking are over -- for lending, for financial services, and even for that one function which has distinguished depository institutions from all others -- taking deposits.

I would like to talk now about what we (the Administration) propose to do about all this. We start with the perspective that the market has already changed, and that the regulators, and the rest of the government, including us, are 10 years behind. We are simultaneously trying to catch up and to get out of the way; indeed, you might say that we are trying to catch up by getting out of the way.

We believe that depository institutions should be allowed to be your full competitors. They are currently the most restricted segment of the financial services industry. Some restrictions will always be necessary to assure safety and soundness, of course.

But a primary example of a regulatory change that is necessary and that has been hard to achieve is the struggle over phasing out Regulation Q.

Congress in 1980 established the Depository Institutions Deregulation Committee (DIDC) and gave it responsibility for phasing out interest rate ceilings over a six-year period. Most Members of Congress recognized that interest rate limitations make depository institutions less competitive with non regulated financial institutions, discourage people from saving, create inequities for depositors, and have not achieved their purpose of providing an even flow of funds for home mortgage lending.

The DIDC at its December meeting postponed considering a plan to phase out interest rate ceilings, and thus the differential, beginning with longer term deposits; but we hope this proposal will be adopted at the March meeting. The Administration believes that eliminating interest rate ceilings should go hand in hand with the passage of legislation that will expand the asset powers of thrifts so that they can invest their higher cost funds at a profit. I'll be discussing these necessary legislative changes later.

First, I want to mention another regulatory change that may affect your industry, because it will make depository institutions directly competitive with you. The Federal Home Loan Bank Board (FHLBB) is currently considering whether to allow savings and loan associations to set up service corporations to engage in limited brokerage activities. If the S&Ls gain permission from the FHLBB, they will file for approval with the Securities and Exchange Commission (SEC) and National Association of Securities Dealers (NASD) to make the new service available to the public. Many details have not been made public but the important point is that this type of historic regulatory change is currently under consideration.

An example of an historic regulatory change in your own securities industry is the Securities and Exchange Commission's announcement last week regarding the easing of net capital requirements. In 1975, when the net capital rule was adopted the Commission felt firms should be required to maintain adjusted assets equal to four percent of customers' debt to the firm. Now, the Commission feels that two percent will be adequate since the recent surge in customer debt has resulted in a substantial increase in the assets being tied up in liquid, low-risk securities. We applaud the SEC's efforts to adjust their requirements to meet the new reality.

The Administration believes that all financial intermediaries -- investment banks, commercial banks, savings and loan associations, mutual savings banks, credit unions, mutual funds, insurance companies, pension funds -- all -- should ultimately be free to compete for the financial consumer's business.

Obviously this is a process that requires care and deliberation if we are to assure the safety and soundness of our financial institutions.

The recent efforts of Members of Congress, in particular those of the Senate Banking Committee chaired by Senator Garn, should be applauded for the extensive review and consideration they have given to proposals to modernize the complex regulatory structure governing our depository institutions. Senate Bill 1720, entitled "The Financial Institutions Restructuring and Services Act" is, for the most part, strongly supported by the Administration as essential to the future viability of our depository institutions. This bill would authorize expanded asset powers for saving and loan associations and mutual saving banks, would permit interstate and cross industry mergers of failing institutions and would authorize other needed changes.

Of particular interest to this audience, however, is Title III of S. 1720 which would begin to remove the legislative barriers between commercial and investment banking by authorizing commercial bank underwriting of revenue bonds and open-end investment companies or mutual fund shares. These activities are currently not open to commercial banks due to the Glass-Steagall Act of 1933. The Glass-Steagall Act was designed for a world in which commercial and investment banking could be considered distinct and separate activities. As I pointed out earlier, that distinction no longer exists. Investment banks are now successfully competing with depository institutions for the same consumer savings.

The Administration supports the intent of Title III of S. 1720 in regard to expanding the authority of banks to engage in what has been traditionally the business of securities firms. However, we have submitted our own bill, "The Bank Holding Company Deregulation Act" as a substitute to Title III. We feel our bill is a better way to take the first step toward opening up competition among the providers of financial services.

Under the Administration's bill, banks would be permitted to provide some securities services through securities affiliates of bank holding companies. These services would include dealing in and underwriting revenue bonds as well as sponsoring and underwriting the securities of mutual funds.

The bill would permit banks with less than $100 million in assets that are not controlled by a bank holding company to establish or acquire a bank securities subsidiary directly. Banks with assets of $100 million or more that want to provide these securities services, however, could do so only through subsidiaries of their bank holding companies.

The bill would also require banks that provide these services through a securities affiliate to transfer to the affiliate all of their activities related to dealing in and underwriting obligations of the United States and general obligations of state or local governments. Banks would have one year to make the transfer.

The important point here -- and this is where the doctrine of appropriate competition is seen most clearly -- is that regardless of whether it is owned by a bank or a bank holding company, a bank securities affiliate would be regulated by the Securities and Exchange Commission, and would be subject to the same tax laws as its competitors.

In addition to these provisions, the Administration bill would require the Federal Reserve Board to draft a definition of the term "financial services" that could be provided by subsidiaries of bank holding companies. In defining the term "financial services" the Federal Reserve Board would give primary consideration to the benefits which will accrue to the public from increased competition between bank holding companies and other firms which offer financial services such as investment advice; leasing; real estate development and brokeraging; data processing; and underwriting or acting as a broker for the sale of insurance. As with the securities subsidiary, each new activity would be subject to regulation on the same basis as if conducted by a subsidiary of an unregulated holding company. The bill would only give the Fed the authority to define the term financial services. The Fed would not have the authority to approve or disapprove specific acquisitions of companies which provide financial services. General antitrust principles would continue to apply, and acquistions in violation with the Fed definition would be subject to the Fed's cease and desist authority.

Further, the proposed legislation spells out specific ground rules covering transactions between a bank and its affiliates. In general, these ground rules would prohibit any preferential treatment for credit transactions; impose limits on the amount of financial assistance transactions between a bank and its affiliates; prohibit a bank from bailing out its affiliates through the purchase of low-quality assets; prohibit a bank from acting as a fiduciary in buying securities or other assets from one of its affiliates; and prohibit a bank from advertising or suggesting that it is in any way responsible for the obligations of its affiliates.

The purpose of these restrictions is two-fold: to insulate the depositors of the bank and the federal deposit insurance fund from the increased risk associated with the activities of the bank affiliates; and to prevent the bank holding company from using the bank's lower cost of funds to the unfair advantage of its subsidiaries operating in other fields and competing with firms not affiliated with banks. The same restrictions would apply to the small bank which, under the $100 million cutoff, establishes its own securities subsidiary.

This proposed legislation is carefully devised to open up competition among the providers of financial services -- competition that will produce more innovative services and greater benefits for the consumers of these services without jeopardizing the safety of depositors' funds or the federal insurance funds. It would also ensure that providers of these services would at last have competitive equity.

Although commercial banks and the thrifts would benefit greatly from this legislation, there are many advantages of our proposal which should accrue to the securities industry. The inequalities existing within ongoing bank securities activities will be eliminated as these businesses are transferred into the subsidiary.

Banks would no longer enjoy preferential tax treatment, particularly as regards the carrying of securities in inventory.

They would no longer be regulated by the Federal bank regulatory agencies for which securities activities are only a limited aspect of bank business.

They would no longer have access to financing based on the cost of the bank's insured deposits.

Moreover, to the extent that securities firms dealing in only Federal, municipal or mutual funds instruments could set up a bank holding company and own a commercial bank within it, our proposal represents a two-way street which will open up many new opportunities to securities firms as well as to commercial banks.

Also, opportunities for the non-arms length linkage of traditional bank services to the securities business of the bank would be severely restricted.

Finally, a wider array of financial services distributed by a greater number of financial intermediaries is likely to result in an expansion of enthusiasm for the securities industry's products. While it is heartening to witness the rekindling of small investor interest in stock ownership there remains a need for this trend to be broadened and strengthened. I believe our proposal would accomplish this -- and I suggest that one hundred million share days accompanied by a strong bull market would benefit all players.

In closing, I would like to point out that the financial services industry faces not a <u>revolution</u> so much as an intense period of <u>evolution</u> toward new forms and methods.

The process of this evolution has a life and dynamism of its own. Since we can not preserve the status quo, all segments of the financial services industry should join the effort to fashion a regulatory structure that bears some relationship to the realities of the market place and that can anticipate and adjust to the consumer's financial needs of the future.

TREASURY NEWS
epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
January 22, 1982

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TREASURY ANNOUNCES ENTRY INTO FORCE OF
FOUR INCOME TAX TREATIES

The Treasury Department today announced the exchange of instruments of ratification of new U.S. income tax treaties with Egypt, Jamaica and Morocco and a protocol to the income tax treaty with Norway. Those four agreements, as modified by certain reservations and understandings of the Senate, are now in force, but their provisions take effect at varying times as described below.

Instruments of ratification of the income tax treaty with Egypt were exchanged on December 1, 1981. The treaty entered into force thirty days later on December 31, 1981. Its provisions with respect to withholding tax rates will take effect on February 1, 1982. With respect to all other taxes its provisions are effective as of January 1, 1982.

Instruments of ratification of the protocol to the income tax treaty with Norway were exchanged on December 15, 1981, and the protocol entered into force at that time. The provisions of Article I, allowing credits against U.S. income tax for certain Norwegian taxes, have retroactive effect to taxable year 1975. The provisions with respect to withholding tax rates will take effect on June 1, 1982. With respect to all other taxes, the provisions of the protocol are effective for taxable years beginning on or after January 1, 1982.

Instruments of ratification of the tax treaty with Jamaica and accompanying protocol were exchanged on December 29, 1981, and the treaty and protocol entered into force at that time. Their provisions take effect on February 1, 1982 with respect to withholding taxes, and for other taxes for taxable years beginning on or after January 1, 1982. The provisions of the 1945 Convention, as amended, cease to have effect when the provisions of this new Convention take effect.

Instruments of ratification of the income tax treaty with Morocco were exchanged on December 30, 1981 and the treaty entered into force at that time. Its provisions take effect as of January 1, 1982 with respect to withholding taxes, and for other taxes for taxable years beginning on or after January 1, 1981.

Six other treaties have been approved by the U.S. Senate, subject to certain reservations and understandings: income tax treaties with Argentina, Bangladesh, Israel, Malta and the Philippines and an estate tax treaty with Germany. Argentina, Malta, the Philippines and Germany are reviewing the reservations and understandings introduced by the U.S. Senate. Bangladesh has indicated that it has difficulty in accepting the Senate reservation requiring most-favored-nation treatment of U.S. shipping enterprises and Israel is reportedly concerned about the Senate's understanding that GAO has access in certain situations to information exchanged by the competent authorities.

The Senate Foreign Relations Committee has deferred its decision on a revised income tax treaty with Canada. A protocol addressing certain issues, notably the taxation of gains on real estate, is now under negotiation.

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TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE UPON DELIVERY
Monday, January 25, 1982

REMARKS PREPARED FOR DELIVERY BY
THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY
TO
THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS
CAPITOL HILTON HOTEL
WASHINGTON, D.C.
MONDAY, JANUARY 25, 1982

Thank you John (John Hutchinson, President of NAFCU) for your kind introduction. It's a very special pleasure to join you here this morning.

And it's special for several reasons. To begin with, I've been involved for most of my adult life in the rough and tumble of the financial marketplace. I admire the creativity and tenacity that's required for survival and growth in such an environment, and I believe that credit unions generally -- the federal credit unions specifically -- exemplify those qualities. Incidentally, I am a member of a credit union -- that of my former employer.

Credit unions outnumber all the other savings institutions in the country. The seventy-four years that succeeded the establishment of the first credit union in New Hampshire have been years of growth -- growth bordering on proliferation.

The latest available figures indicate that the 21,300 credit unions in the United States control assets of almost $74 billion. As you know the industry is dominated by the federally chartered credit unions -- a little more than 12,000 of them, with assets of slighly more than $40 billion.

That's an American success story. And I say American not simply because of geography, but because your success has been founded on some peculiarly American values -- the spirit of cooperative effort for one, and a willingness to stand in the marketplace, rather than behind the government's skirts, for another.

Those are values which could well be emulated by some other segments of the thrift industry. Indeed they're one reason that credit unions are currently performing better than the rest of the thrift industry.

Let me add that another reason is the enlightened regulatory atmosphere in which you've operated. The National Credit Union

Administration is one reason that you are further along on the road to deregulation than any other segment of the thrift industry. As a result, you've had the flexibility to deal with the pressures of high interest rates and an inflationary environment.

It hasn't been easy. Credit unions have experienced earnings pressures and the erosion of capital. But generally speaking you've had enough regulatory room to maneuver and to use the managerial creativity so essential to survive in the marketplace.

I'd like to turn now to the broader financial marketplace, and to the Administration's position on deregulating the financial services industry. I'd like to begin by articulating several philosophical principles that this Administration considers axiomatic. Then look at the condition of the financial marketplace and finally at some specific Administration proposals.

First among our philosophical principles is this: there is no mechanism more efficient in the allocation of resources than the free market, <u>and the financial marketplace is no exception</u>.

Second, free markets have strong self correcting forces which must be allowed to work, <u>and the financial marketplace is no exception.</u>

Third, free markets are dynamic systems that have the capacity to create wealth, <u>and the financial marketplace is no exception.</u>

Perhaps nowhere in our economy have those principles been more honored in the breech than in the financial services industry. They have been abrogated at untold costs in efficiency and convenience.

Generally speaking, the contravention of those principles by federal and state governments has distorted the marketplace -- and those distortions have been amplified by advances in technology undreamed of when most of the statutes and regulatory institutions were established.

It's as if the National Football League required both of yesterday's Super Bowl participants to wear leather helmets.

I'd like to examine the condition of the modern financial marketplace. But perhaps the best way to begin would be to tell you the story of three people who had died, and were standing at the gates of heaven awaiting admission. One was a surgeon, another was an engineer, and another an economist.

Saint Peter said there was only room inside for one more person, and he was agonizing over whom to select, since on earth they'd all been good, upright people.

So he thought for a while and finally said, "I think I've come up with an idea. See if you all agree. I'll choose the man whose profession is the oldest."

They all said, "Fine" -- that seemed fair to them.

First, the surgeon spoke up, "I certainly am the man with the oldest profession when you consider the fact that, right after God created Adam, He operated on him, took out a rib and created Eve. So surgery is the oldest profession."

The engineer said, "Wait one second, here. Before God created Eve or Adam, he took chaos and built the Earth in six days. Engineering obviously preceded surgery."

Finally, the economist said, "Hold on, fellows; Hold on. Who do you think created the chaos?"

Clearly, when one looks at the financial markets today, it's not chaos one sees so much as change -- change occurring at a stupendous velocity.

Changes in technology are making banking as we know it obsolete. You are familiar with ATM's and cash dispensers in airports. Many of you may consider ATM's the wave of the future; in truth, with 25,000 already installed nationwide, they are the "wave of the present."

Indeed, the young adults and children, of today, probably consider these developments old hat. They've grown up with computers and accept them as a natural part of their world, much as we did the telephone.

Many of your own children are probably developing applications for home computers; and learning math and spelling from hand-held machines. For them, the old maxim "don't trust anyone over thirty" may take on a new meaning: they will not trust us because we have become technically incompetent and technologically obsolete.

In the future, thanks to cable television, satellites, and the telephone, the consumer will not even have to go to the bank, or to an airport, or to an ATM. He will do his banking from his home or place of business. Indeed, not just his banking, but all of his financial business, including stocks, bonds and insurance will be done from home.

And this is not the distant future: Touch-tone billpayer services are already with us, and I recently read of a Midwest grocery store which directly debits customers' checking accounts from the check-out line.

A joint venture of Warner Communications and American Express already offers an interactive "two-way" cable system, and this subsidiary was awarded franchises covering more than two-thirds of the homes for which franchises were offered in 1980. One communications industry consultant has predicted that some form of in-home banking will be available to a fifth of American households in the next five years.

My point is this: the old days of brick-and-mortar banking are over -- for lending, for financial services, and even for that one function which has distinguished depository institutions from all others -- taking deposits.

As I suggested earlier these advances were undreamed of fifty years ago, except perhaps by H. G. Welles.

Then too, fifty years ago most markets were relatively localized and fragmented. Fifty years ago, butchers sold meat, fruit and vegetable stands sold produce, drugstores sold medicines, and other shops sold sundries. The advent of the supermarket put many of these single-service shops out of business, and substantially changed the way the remainder conducted their operations.

We are seeing the creation of similar supermarkets in the financial services industry today. I am not predicting the demise of specialized financial institutions.

The customer's need for specialized, individual assistance for his financial affairs will remain. A market for specialized institutions will exist. However, banks and other depository institutions that wish to specialize should do so by choice; they should not specialize because they are required to do so by government regulation.

Archaic regulation in the financial services marketplace has produced structural and economic ironies.

Despite volumes of laws and regulations intended to segregate product lines and isolate institutions, the money center banks still offer credit cards, check cashing, consumer finance and travel planning nationwide, loans in most states and mortgages in some locations.

Manufacturers Hanover of New York recently bought a string of 67 finance offices in California, Oregon and Washington.

My erstwhile employer, Merrill Lynch, offers mortgages, check-writing, trust and estate planning, and money management.

Prudential Insurance has acquired Bache, Halsey, Stuart, Shields.

Four savings and loans are now seeking to operate a securities brokerage subsidiary, and to offer investment advice and portfolio analysis. An additional 150 to 200 S&L's have indicated an active interest in becoming associated with this subsidiary.

And these are the "regulated" institutions. The unregulated institutions have even greater flexibility.

Sears has long offered insurance and consumer credit. It recently acquired the nation's fourth largest brokerage firm, decided to establish a money market fund, and purchased the nation's largest real estate brokerage firm. It is also the largest savings and loan holding company in the United States.

American Express offers credit cards, cable television, securities brokerage and underwriting, traveler's checks and travel planning (as well as cash at the airport).

General Electric is involved in real estate loans, second mortgages, commercial real estate financing, mortgage insurance and leveraged leasing.

National Steel -- yes, National Steel -- owns three savings and loans.

Baldwin-United, formerly better known for its pianos, has also acquired a savings and loan and a string of banks. Even the funeral directors of the state of New Jersey will accept deposits. They put them in a fund which covers funeral expenses, and also pays money market rates of interest.

An important characteristic of many of these financial supermarkets is that they operate nationwide. Sears has 800 department stores and 283 Dean Witter offices. American Express has 1100 offices plus 246 Shearson offices. General Electric has 300 branches. Merrill Lynch has 442 offices. The "Pru", in addition to its nationwide insurance offices, now has 164 Bache offices, and, of course, a piece of the rock.

The issue of "interstate banking" seems pale in comparison with numbers of this magnitude. Indeed, to speak in domestic terms alone may be too narrow, when six of the ten largest banks in California are owned by home offices in foreign countries.

Of course, implicit in all these "supermarket" strategies is a recognition of the convenience of one-stop shopping and the importance of customer contact.

Now what does the Administration propose to do about all this?

We start from the perspective that the market has already changed, and that the regulators, and rest of the government, including us, are 10 years behind.

We are simultaneously trying to catch up <u>and</u> to get out of the way; indeed, you might say that we are trying to catch up <u>by</u> getting out of the way.

Secondly, we start with the recognition that change is inevitable. Financial supermarkets are coming, as are higher-cost deposits, new financial services, and some form of in-home banking. Thus, the issue of deregulation is not whether new financial services and new competition for banks and S&L's will exist; the issue is whether depository institutions will be able to compete with other institutions already offering these services.

We believe that -- ultimately -- all depository institutions should have the opportunity to underwrite revenue bonds and to offer money-market mutual funds and other services traditionally barred to deposit-taking institutions. Conversely, securities firms ought to have the right to get into the banking business.

As a first step, we have proposed that commercial banks be able to underwrite revenue bonds and offer money market mutual funds through affiliates of bank holding companies, such as an affiliate for securities activities.

There would be one exception to this for small banks. Banks with assets of less than $100 million could conduct these activities through a separate subsidiary of the bank itself without incurring the burden of establishing a separate bank holding company structure.

Conducting securities operations through an affiliate would ensure that these operations are subject to the same taxation and laws -- e.g., Securities and Exchange Commission regulations -- as existing securities firms.

Securities companies wishing to enter banking could establish a holding company and own a commercial bank within that company -- a commercial bank which would be subject to the rules of bank regulators. This approach would also protect depositors from the higher risks associated with non-bank activities.

Before I move on, let me emphasize the significance of the affiliate concept. Indeed, it is the most important part of the Administration's position. We will <u>not</u> give commercial banks the competitive advantage -- the unfair competitive advantage -- of exercising their new powers directly.

Let's be very clear on this point: Not only should the playing field be level, the rules should be identical for the players. The affiliate concept for commercial banks' securities operations is essential to equity.

Allowing large commercial banks to compete with the securities industry directly would be the same as having one of the contestants in the Super Bowl run up hill. Just as the opposition would come to dominate the game, so too would commercial banks eventually come to dominate the securities industry.

This unfair competitive position of commercial banks would arise in the tax-exempt bond market from two government conferred legal advantages that traditional underwriters don't enjoy.

First of all, banks can carry securities inventories by using funds from deposits paying a controlled low interest rate, or no interest at all.

And, second, banks can deduct the interest expense of carrying these inventories from their taxes.

Together, these provisions confer a substantial advantage on banks -- an advantage conferred by the government.

Ironically, some bank executives seek to keep that unfair competitive edge, while simultaneously complaining about favorable legislation currently enjoyed by the savings and loan or securities industries.

The Administration's affiliate proposal is not intended to protect securities firms from competition, its purpose is to make that competition fair. I submit that the government should be even-handed. We should not knowingly confer preferential treatment on any competitor.

If this Administration were to do otherwise, it would be untrue to the principles that I enunciated earlier. We are not in government to confer advantage, but to liberate the vitality of the marketplace.

We believe in what President Reagan called, "the magic of the marketplace." We believe that -- given a rational, enlightened regulatory environment -- the marketplace will allocate resources efficiently and equitably.

We believe that the principles I mentioned earlier are true of the economy as a whole, and of the financial services industry particularly. And we fully intend to see them embodied in public policy -- to cast this economy and the financial services industry in a free market mold -- one that will last into the indefinite future.

I suspect that most of you in this audience share those beliefs. I hope you and everyone connected with the nation's credit unions -- federal and otherwise -- will join us in the effort to restore the fullest possible degree of freedom to the financial services industry.

Thank you.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE

January 25, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $5,002 million of 13-week bills and for $ 5,002 million of 26-week bills, both to be issued on January 28, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 29, 1982			:	26-week bills maturing July 29, 1982		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.632a/	13.324%	13.98%	:	93.192	13.466%	14.65%
Low	96.614	13.395%	14.06%	:	93.150	13.549%	14.75%
Average	96.622	13.364%	14.02%	:	93.160	13.530%2/	14.72%

a/ Excepting 4 tenders totaling $2,630,000.

Tenders at the low price for the 13-week bills were allotted 62%.
Tenders at the low price for the 26-week bills were allotted 87%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 60,290	$ 51,415		$ 64,080	$ 52,955
New York	10,999,675	4,133,620	:	9,978,075	4,254,215
Philadelphia	84,260	50,980	:	27,880	24,830
Cleveland	90,420	56,615	:	129,515	32,960
Richmond	53,605	48,780	:	83,990	49,490
Atlanta	77,455	69,245	:	104,530	57,320
Chicago	575,205	71,590	:	532,080	69,080
St. Louis	46,490	35,590	:	49,430	27,930
Minneapolis	20,415	10,880	:	34,615	14,615
Kansas City	57,855	55,630	:	77,325	67,725
Dallas	45,595	30,595	:	22,045	17,045
San Francisco	578,960	127,785	:	536,660	85,260
Treasury	258,960	258,960	:	248,110	248,110
TOTALS	$12,949,185	$5,001,685		$11,888,335	$5,001,535
Type					
Competitive	$10,534,215	$2,586,715		$ 9,361,505	$2,474,705
Noncompetitive	1,264,335	1,264,335	:	1,009,830	1,009,830
Subtotal, Public	$11,798,550	$3,851,050		$10,371,335	$3,484,535
Federal Reserve	791,535	791,535	:	775,000	775,000
Foreign Official Institutions	359,100	359,100	:	742,000	742,000
TOTALS	$12,949,185	$5,001,685		$11,888,335	$5,001,535

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.930%.

R-583

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. January 26, 1982

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 10,000 million, to be issued February 4, 1982. This offering will provide $ 925 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $ 9,071 million, including $ 1,485 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $ 1,545 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 $5,000 million, representing an additional amount of bills dated November 5, 1981, and to mature May 6, 1982 (CUSIP No. 912794 AP 9), currently outstanding in the amount of $ 4,733 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 5,000 million, to be dated February 4, 1982, and to mature August 5, 1982 (CUSIP No. 912794 BG 8).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing February 4, 1982. Tenders from Federal Reserve Banks for themselves and as agents for 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 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, February 1, 1982. 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 as of 12:30 p.m. Eastern time on the day of 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 February 4, 1982, in cash or other immediately-available funds or in Treasury bills maturing February 4, 1982. 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 Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of. Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

EMBARGOED FOR RELEASE UPON DELIVERY
Expected at 10:00 A.M., EST
Wednesday, January 27, 1982

TESTIMONY OF THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY
BEFORE THE
JOINT ECONOMIC COMMITTEE

Mr. Chairman and Members of the Committee:

As we embark on the second year of this Administration, it is helpful to examine where we have been, where we are now and where we are going. This before and after picture will illustrate clearly, I believe, the progress--modest but positive-- we have made in trimming down an overgrown Federal government, curbing the excesses of past policies, and setting the stage for a decade of noninflationary growth.

First, let us examine the legacy of stop and go fiscal policies, erratic monetary policy, rapid inflation and rising interest rates, declining productivity and a weakening real economy that was left to this Administration when we arrived one year ago. Not only were all the major economic trends unfavorable, but traditional approaches to these problems seemed incapable of pinpointing the source of the problem or of finding a solution.

Years of Declining Performance

Following the recovery from the 1974-1975 recession, real GNP growth declined steadily, from increases of 5.5 percent year over year in 1977, 4.8 percent in 1978, and 3.2 percent in 1979 to a decrease of 0.2 percent in 1980. Contrary to the conventional wisdom that slower growth would reduce inflation, inflation worsened. The CPI rose 6.5 percent year over year in 1977, 7.7 percent in 1978, 11.3 percent in 1979, and 13.5 percent in 1980.

With higher inflation came higher interest rates. After averaging just over 5 percent in 1977, the 3-month Treasury bill rate tripled to over 15.5 percent by December of 1980, having spent 11 of the previous 16 months in double digit territory. The prime rate was 21.5 percent in December of 1980, having exceeded 13 percent in 12 of the previous 16 months.

Productivity, measured year over year, fell from 1977 to 1980. This was reflected in wages. Even after allowing for overtime and shifts of jobs among industries, real average hourly earnings were lower in 1980 than in 1971! Meanwhile, tax burdens generally were substantially higher, reducing take-home pay per worker even further.

Inherited Fiscal Policy

During this period of general decline, the government kept growing. This was not a new development. Through Fiscal Year 1981, government spending had risen by an average of 12 percent per year during the decade. Budget outlays rose from between 20 and 21 percent of GNP in the early 1970's to a postwar record of 23.1 percent in Fiscal Year 1981--nearly one dollar in every four generated by our economy. Outlays soared nearly 200 percent during the decade of the seventies.

The tax burden was rising as well. In spite of legislated tax reductions the overall tax receipts of the Federal government rose nearly $250 billion from FY 1977 to FY 1981 and still we accumulated deficits of almost $200 billion. In spite of tax reductions, personal income taxes as a percent of personal income rose from about 10 percent in 1975 to 11.5 percent by 1980 and had been projected to rise to over 15 percent by 1986 without any major tax reduction. If we take account of social security tax increases, the average tax rates rose from 12.7 percent to 14.5 percent during this period and would have increased to nearly 19 percent by 1986.

Average tax burdens do not tell the whole story, however. Because of the steeply progressive rate structure of the individual income tax, inflation forced taxpayers into higher marginal tax brackets even though average tax rates were occasionally and temporarily being reduced by a series of generally ineffective tax bills. This created serious problems for work incentives, saving and investment. Personal savings rates fell from 8.6 percent of disposable income in 1975 to 5.6 percent in 1980, and bottomed out at a low 4.3 percent in the first quarter of 1981. In the labor markets, the rising marginal tax rates were impairing the competitive situation of U.S. labor in the world economy. The rising rates gave further impetus to the shift away from straight wage increases into non-taxable fringe benefits, shorter hours and more days off with pay.

Businesses fared no better. Inflation increased their tax liabilities and distorted their saving and investment decisions due chiefly to the fact that depreciation allowances were not adjusted for the rising cost of plant and equipment in computing taxable income. The rate of return on plant and equipment plummeted, reducing investment and productivity growth sharply.

Monetary Policy

The President's original economic program included the recommendation that money growth be gradually reduced to a non-inflationary pace. During the past year, the Federal Reserve made significant progress toward that goal.

Fourth quarter to fourth quarter, M1B grew slightly less than 5 percent in 1981. Compared to the inflationary rates of monetary expansion in the past--7.3 percent in 1980 and an annual average of 8.0 percent in the preceding three years--this is a substantial deceleration in money growth. The Federal Reserve's tentative target ranges for 1982, 2-1/2 to 5-1/2 percent for M1, represent continued progress toward noninflationary money growth and the Administration fully supports that general policy.

The Administration's original recommendation was that the rate of money growth gradually be cut in half by 1984 from the average 7.8 percent rate of the prior four years; this is the assumption that we built into our economic projections. The deceleration that has actually occurred has been much more rapid--we have gotten almost three-fourths of the planned reduction in the first year.

This more rapid deceleration of money growth has economic consequences--some good, some bad. It is leading to a faster reduction in inflation, but it also means that the associated restrictive effect on nominal GNP and incomes reduces growth in Federal revenues ahead of growth in Federal spending, thus contributing to higher budget deficits. It is amply clear from history, both here and abroad, that deficits, if not monetized, do not produce inflation. Indeed, the lower rate of inflation is a partial cause of the current deficit.

Recognizing the short-run costs and the long-run benefits of controlling inflation, the Administration remains committed to its goal of slow and steady money growth over the long run. Given that goal, we supported money growth in the middle of the Federal Reserve's M1B target range in 1981, and we support money growth in the upper third of the Federal Reserve's tentative M1 target range for 1982.

The erratic pattern of money growth that occurred in 1980 and in 1981 and which contributed to the onset of the current downturn. At various times during the year, we at Treasury have hinted, sometimes in private, sometimes in public, that we would like either faster or slower money growth. Some have accused us of being unable to make up our minds.

Nothing could be further from the truth. We have consistently urged faster money growth when the money supply was flat or declining, and slower money growth when the money supply was rising at double digit rates. We supported the Federal Reserve's targets, and consistently urged them to keep money growth even and steady within the target range.

In the last three months of 1980, M1B fell at an annual rate of one percent per year, after a sharp rise in the previous five months. Virtually all of the growth in M1B in 1981 occurred in the first four months of the year, when it grew at a 13.3 percent annual rate; and the last two months of the year, when M1B growth was at a 13.0 percent rate. In the interim, M1B oscillated from week to week. In the six months from April to October, the net change was a decrease of 0.1 percent. Such volatile money growth has very damaging effects on the economy. It destroys the credibility of long-run monetary controls, adds to uncertainty and risk, and thereby helps keep interest rates high as lenders seek to protect their principal.

This very erratic pattern has kept financial markets in a state of disarray for some time. During 1981, there appeared to be a particularly close relationship between variability in monetary growth and short-term rates. Acceleration in monetary growth was associated with sharp increases in short-term rates, while deceleration in monetary growth was associated with declines in short-term interest rates. This is an important lesson. Faster money growth causes interest rates to go up, not down.

The past two months provided a good example of the disruptive effects of volatile money growth. Since October, the rate of money growth has accelerated rapidly, following six months of near-zero growth. The rapid reacceleration of money growth has renewed concerns about inflation, renewed skepticism about monetary control in general, and created enormous uncertainty in the financial markets. The result has been a reversal of the dramatic decline in interest rates that had been under way since September. I hope that those who still believe that high interest rates are caused by a "tight" monetary policy have been paying attention.

For these reasons, the Administration would like to see a moderate rate of money growth, in the upper third of the Fed's new target range, achieved in a steady and consistent pattern. While precise money control over short periods of time cannot realistically be expected, the extreme fluctuations experienced in recent years could and should be dampened. In fact, a steady monetary policy is absolutely essential if we are to steady the financial markets and reduce interest rates. Stability of policy is the key requirement for any permanent recovery in output and employment.

The 1980 and 1981 Downturns

The economy in early 1980 had been weakened by several factors. There had been four years of excessive money growth, rising inflation, rising interest rates, rising tax rates, and rising Federal spending as a share of GNP. Rates of return on investment and savings were severly depressed. The interest-sensitive sectors, such as autos and homebuilding, were already in a severe slump.

The economy badly needed a period of moderate and steady monetary expansion. Instead, 1980 and 1981 witnessed some of the most pronounced swings in the monthly and quarterly growth rates of the money supply in history. These swings contributed to sharp movements in interest rates, mostly upward, and helped to spread the weakness in the initially depressed sectors throughout the economy.

The second quarter of 1980 was one of sharp collapse, at a 9.9 percent annual rate. It was followed by two quarters of very slow recovery, with 2.4 and 3.8 percent growth. Not until the 8.6 percent growth of the first quarter of 1981 did real GNP exceed that of the first quarter of 1980.

Unfortunately, the 1981 recovery was soon choked off in what might best be described as a continuation of the 1980 situation. Homebuilding and autos had never really recovered from the slump of the previous year. The basic causes of the 1980 downturn had never really been corrected. The causes were the same: erratic money growth, continued high inflation and interest rates, and rising tax rates.

By the spring of 1981, autos, construction and consumer durables were under renewed pressure, responding to the renewed upturn in interest rates, which were driven back to near-record levels by the upsurge in money growth from February to April. Real GNP fell 1.6 percent at an annual rate in the second quarter, although it recovered a bit in the third, rising at a 1.4 percent annual rate, before declining at a 5.2 percent rate in the fourth quarter. Industrial production showed very little growth from March to July. It peaked in July and fell rapidly thereafter through the end of the year. The National Bureau of Economic Research has picked July as the peak month of the expansion, although the economy was clearly not healthy for several months prior to that point. One could just as easily characterize 1980 and 1981 as a single period of zero growth or recession. Real GNP (seasonally adjusted annual rate) in the third quarter of 1981 was only 0.4 percent greater than that in the first quarter of 1980; the preliminary estimate for the fourth quarter of 1981 is for real GNP 0.4 percent less than in the 1st quarter of 1980.

What we have been through is an extended period of very poor and erratic economic performance. It has been characterized by erratic money growth, uncertainty in the financial markets, sharp increases in interest rates and pronounced distress in housing, autos and consumer durables. What is needed is a clear resolution of monetary policy to provide a strong base for recovery of these industries and a strong expansion of the entire economy.

<u>Economic Recovery Program</u>

This was the situation we inherited. Fortunately, we understand its causes, and have put into place a four-part program to correct the errors of the past, and to restore economic growth and full employment while reducing inflation.

- With the help of the Congress, we achieved significant reduction in the growth of Federal spending for Fiscal Years 1982 and beyond. The spending reductions already enacted and those still to be proposed cut the rate of growth of spending roughly in half and will bring spending down to about 22 percent of GNP by 1983. Further spending reductions, coupled with faster economic growth, will bring us closer to our long-term goal of 19 to 20 percent of GNP in the years ahead.

  This is not an ideological goal. It is a necessary step to return the real and financial resources now being absorbed by the government to the private sector, where they can be used for investment and growth.

- An incentive tax policy is in place. The Economic Recovery Tax Act was signed into law in August 1981 with its major provisions taking effect over five calendar years. This is not a random tax cut to give away money, only to have the government borrow it back. It is a carefully structured tax cut designed to raise the rewards to each additional hour worked and each additional dollar saved, to encourage people to supply more effort, more saving and more investment to the economy.

Under the full three-year incentive tax rate reduction, followed by indexing in 1985, bracket creep that has been poisoning labor negotiations and pricing U.S. labor out of world markets is at an end. The rising marginal tax rates that, with inflation, have cut personal savings rates in all brackets almost in half between 1975 and 1980, will be reduced. Discriminatory tax rates on income from saving have been ended.

The accelerated cost recovery system shortens the period over which investments in business property may be recovered for tax purposes and simplifies this cost recovery computation compared to the prior depreciation system. Along with the increases in the investment tax credit, it will restore a reasonable rate of return on investment in plant and equipment. For the first time in years, firms will be allowed a tax write-off large enough to let them fully replace their plant and equipment, the costs of which have been rising sharply with inflation.

- Regulatory reform is under way to reduce the inefficiencies and enormous costs that are holding back production and raising prices. It will be a labor of many years.

- Monetary policy, although still unsteady, has shifted toward reducing inflation. Restraint was most noticeable beginning in May of 1981. We have encouraged the Federal Reserve to keep money growth steady at levels consistent with a gradual return to stable prices and low interest rates.

The causes and the timing of the recession are obvious to any reasonable observer. The economy was peaking out and entering the recession months before the Administration's economic program was in place. The spending reductions and tax changes were enacted after the recession began, and will have their major impact in Fiscal Year 1982 and beyond. There is no school of economic thought--Keynesian, monetarist, or supply side--which provides even the hint of a suggestion that any of the policies called for by the Administration could have retroactively brought on this downturn. Indeed, spending restraint and tax incentives are widely recommended policies for encouraging growth and modernization of the private sector. Stability in monetary policy tends to reduce interest rates and inflationary expectations and is a necessary precondition for the saving and investment essential to growth. If fact, there is no other way to reduce interest rates on a permanent basis.

These policies are just beginning. It will take time for them to work. However, there are signs of progress already.

- Consumer prices, which rose 12.4 percent during 1980, rose 8.9 percent in 1981.

- Producer prices for finished goods, which rose 11.8 percent during 1980, rose only 7.0 percent in 1981, and indicate continued moderation at the consumer level in the months ahead.

- Interest rates, driven by inflation to record highs in the last two years, have since fallen. The prime rate, 21-1/2 percent a year ago, is now at 15.75.

- Manufacturers' durable goods orders, an important leading indicator, have shown broad-based increases in the last two months. Housing starts are up. These are signs that the economy may be heading up by the second quarter.

To be frank, we had initially hoped to do better. We had hoped to bring interest rates down last spring instead of this fall, and to avoid an outright recession. Unfortunately, the economy could not hold out under the accumulating burdens of past policies beyond the first quarter of 1981 to give us time to act.

In addition, our program was subjected to a number of revisions and delays in implementation.

We had hoped for about $160 billion in spending reductions over the period through 1984 in round one of the Administration's spending cuts. We got about $30 billion less. We had hoped to bring spending down to about 19 percent of GNP by 1984. Spending restraint and faster economic growth will gring us part way toward that goal, but it will take a few years longer than originally planned.

We had hoped for a 30 percent personal tax rate reduction starting July 1st at 10 percent a year for three years. We got a bit under 25 percent, on average, with the first installment reduced to 5 percent and delayed until October 1st of last year. That amounts to only 1.25 percent for tax year 1981. In fact, bracket creep and social security tax increases produced roughly a $15 billion tax increase for 1981 in spite of the 5 percent cut. The net personal tax rate reduction for calendar year 1982 will be only 10 percent instead of 20 percent, and will be roughly offset in dollar terms by bracket creep and social security increases. Only in 1983 and 1984 will the majority of families experience real savings. We have prevented major tax increases

We had hoped for a steady money growth rate in 1981. Instead, the uneven 1981 pattern of money growth, following an erratic and unsettling money supply pattern in 1980, kept financial markets in a state of disarray. Interest rates fell early in the year, rose to near-record levels again in the spring as money growth accelerated, remained high in the summer, and did not decline substantially until fall as money growth and inflationary expectations slowed over several months.

The Task Remaining

We must continue to restrain the growth of Federal spending to enable the economy to grow out from under the spending burden. Whether financed by taxes or borrowing, government spending absorbs physical and financial resources better used for private sector growth. Manpower, finished goods and raw materials consumed by government are urgently needed to expand and modernize the private sector. More of the real output of the private sector must be left to those who produce it, to reward workers and savers for their efforts.

While selected tax changes may be desirable to eliminate outmoded provisions in the tax law, care must be taken to preserve the saving and growth incentives embodied in the Economic Recovery Tax Act. Higher levels of private sector saving, over $250 billion more in 1984 than last year will finance government and private sector borrowing needs without inflationary money creation by the Federal Reserve. Renewed economic growth at sustainable rates, spurred by the investment and work incentives, will yield substantial revenue gains from current levels and, by reducing unemployment and poverty, will relieve pressures on the Federal budget for safety net spending.

The basic cause of the currently projected deficits is not the tax cut, which, on the personal side, is not a net tax cut for some years to come. The basic cause of the projected deficit is the sluggish economic performance of 1980-1981 and the continued rapid growth of government spending in real terms. For each additional point of unemployment, the deficit is widened by about $25 billion as revenues fall and outlays rise on income maintenance programs.

Economic growth is the single best means of narrowing deficits. In spite of all the tax changes we have enacted, the $3 trillion U.S. economy, if it were growing at four to five percent per year in real terms, would generate $30 to $35 billion in additional real tax revenues each year in 1981 dollars. If we had projected a scenario holding Federal spending constant in real terms, which itself would facilitate economic growth, and allowed for the growth induced by the Economic Recovery Tax Act, we could have projected the elimination of our remaining deficits by 1985. However, even under the second round of spending proposals we will be submitting to the Congress, there will be continued real growth of the Federal budget. This will delay achieving the budget balance for a bit longer, and serves as a reminder that more work is needed to bring Federal spending under control.

Spending reduction and economic growth are the only methods for balancing the budget while increasing employment, take-home pay and living standards. On the other hand, without spending restraint and faster real economic growth, it is doubtful that we will ever see a balanced budget.

I understand the concerns of Congress and the financial markets over the deficit. Deficits do matter. They matter very much. They matter because of where they come from--excessive spending and inadequate real growth--and what they sometimes lead people to propose--massive, ill-designed tax increases or excessive, inflationary rates of money creation.

Excessive spending reduces growth by diverting real resources from those in the private sector who would use them to expand output and employment. Tax increases, particularly of the type which have been generated over the last decade by inflation, bracket creep and underdepreciation, cripple the incentive to save, invest and work. Taxes dip into personal savings and business retained earnings which might have gone into investment and growth, with even more undesirable disincentive side effects than Federal borrowing. Inflationary money creation is equally to be feared. Under the threat of renewed inflation, savers will not take the risk of setting sufficient funds aside to finance the real growth and job creation we need.

All deficits must be financed out of private savings. We are confident that the saving of households and businesses over the next few years will be adequate to finance both the projected deficits of the total government sector and a very rapid increase in real capital formation. Normal year-to-year increases in saving run $40 to $50 billion each year. Adding a conservative estimate of the personal savings and additional business retained earnings induced by the ERTA brings the increase in saving over 1981 levels to about $60 billion in 1982 and over $250 billion in 1984.

I know, too, that there has been concern over the apparent reluctance of business to plunge ahead with new investment. It is not surprising that some businessmen are holding back until they are certain it is safe to proceed

Some investors expect, or at least hope for a drop in interest rates, which are unusually high given the current relatively low rates of inflation. Others are simply nervous. They are made so in part by the erratic signals given off by the monetary statistics of late. But the most unsettling events are the repeated calls in certain quarters for drastic modifications in the business and personal tax incentives contained in the ERTA. This uncertainty is delaying the economic recovery. Those who have been burned repeatedly by frequent changes in government policy may be forgiven for wondering if Washington can ever stick to a program long enough to make it work.

What the economy needs is a respite from the burden of excessive spending growth. If given time to grow out from under the spending burden, the economy can perform wonders. Pressure for inflationary money growth, and talk of delaying the savings, investment and work incentives in the ERTA, would be part of the problem, not part of the solution. The best thing we can do for the economy is to get behind the President's program and see it through.

With your help, and the help of the millions of American workers, savers, and enterpreneurs across the country, we can, and we will, achieve the twin economic goals of this Administration--stable prices and prosperity for all.

Initiatives for 1982

The President has recommended a number of initiatives for 1982 which will improve the performance of the economy and revitalize our urban centers.

The New Federalism

Federalism has been a theme of President Reagan throughout his public career. He is committed wholeheartedly to returning authority, responsibility, and flexibility to State and local governments. When accepting the Republican nomination for President, he declared "everything that can be run more effectively by State and local government we shall turn over to State and local government, along with the funding sources to pay for it."

The first step toward transferring power back to the States was to move from categorical grants to block grants. We have made substantial progress in this area. Fifty-seven former categorical programs have been combined into nine new or modified block grants with budget authority over $7.5 billion.

The ultimate objective of this change, however, is to create a bridge leading to the time when State and local governments will have not only the responsibility for the programs that properly belong at the State and local level but the tax resources as well.

The new Federalism approach offers the advantage of greater administrative efficiency and the opportunity to encourage innovative solutions by local officials to meet the needs of their communities. As Federal mandates and restrictions are removed from programs that are transferred to State and local governments, significant administrative savings can be achieved because the cost of Federal overhead for planning, audit and review--often duplicative and unnecessary--will be eliminated. The transfer of power and responsibility, along with the funds, will permit government decisions to be made by local officials who can be held accountable for those decisions. This will result in greater diversity of services that will reflect more closely local needs and encourage more innovative and more efficient ways of providing these services at the lowest cost. Unquestionably, we can maximize efficiency and minimize costs by bringing government closer to its citizens and providing local officials the decision making responsibility to chart their own futures.

At the same time, efficiency of government will be strengthened if certain functions, now shared with State and local governments, are provided solely by the Federal Government. Programs that fall into this category are primarily those which involve little regional variation in cost and are more equitable and effective if they provide uniform benefits and eligibility criteria regardless of where the recipients live.

In light of these considerations, the President has proposed a dollar-for-dollar budget exchange of programs with the States and localities. Some 40 programs involving welfare, transportation and education will become State and local responsibilities. States will assume full responsibility for AFDC, food stamps and child support enforcement by 1984. At the same time, the Federal government will assume full responsibility for Medicaid.

Funding for these transferred programs will be provided from an expanded trust fund administered by Treasury. The fund would contain monies currently allocated to Revenue Sharing, Community Development Block Grants and Urban Development Block Grants. To these would be added the revenues from current excise taxes and the windfall profits tax.

The trust fund and the States' savings on Medicaid would more than make up for the cost of the assumed programs during the initial phase of the transfer, 1984-1987. Over the next three years, all Federal excise taxes would expire, with the States free to pick them up as a new revenue source, or to take other tax or budget action with regard to the programs.

Tax Initiatives

The Administration will propose a slightly modified version of the package of tax changes which the President suggested last September. They are designed to remove a number of provisions of the tax code which are no longer warranted or which were made obsolete by the passage of the Economic Recovery Tax Act. In addition, several changes are recommended to improve compliance with provisions of current law and to ensure that constructive provisions of the code do not lead to the unintended result of eliminating tax liability for companies which are not losing money.

Administration Enterprise Zone Proposal

The Enterprise Zone proposal represents an attempt to create jobs and redevelop blighted areas by promoting an environment that is conducive to new business ventures and the expansion of existing business activity. Although Federal, State and local participation will be important to the success of the Enterprise Zone program, the driving force must come from private sector initiatives. The role of the public sector will be more like that of a catalyst.

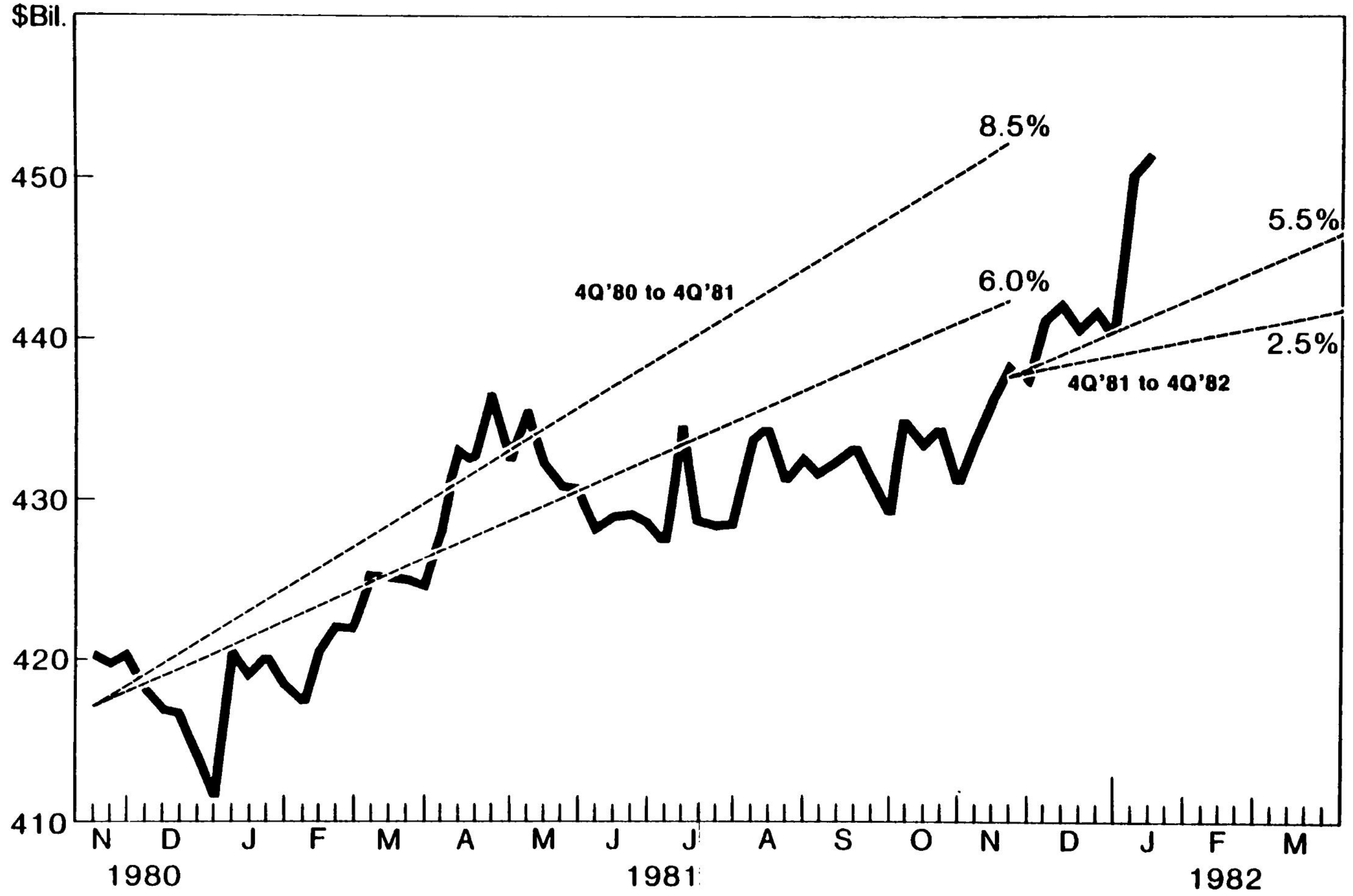
The Enterprise Zone program provides tax incentives and relaxes government regulatory barriers to encourage economic growth in designated Zones. The purpose of the incentives is to help overcome the extraordinary conditions and costs (e.g., crime and insurance costs, lack of skilled labor, inadequate infrastructure and government services) that discourage the location of economic activity in distressed areas; encourage the creation of jobs for economically disadvantaged workers; and encourage other workers to seek employment in these Zones.

The Federal income tax credits are designed to lower the costs of labor and capital used in the Zones. Labor and capital are the two principal productive inputs; these credits are an efficient way to lower the cost of producing goods and services in what would otherwise be high cost areas.

States and localities will be encouraged to add to the Federal tax and regulatory relief efforts with incentives of their own. In particular, we hope that there will be a concerted effort to improve city services and infrastructure in the Zones. We also hope for local planning assistance which might encourage a few major developers, manufacturers or small business groups to consider entering the Zones simultaneously. The neighborhood costs of a depressed environment, which might be too much for a single pioneering firm to bear, can be lowered dramatically if many properties are rehabilitated at once, and many businesses enter the area together.

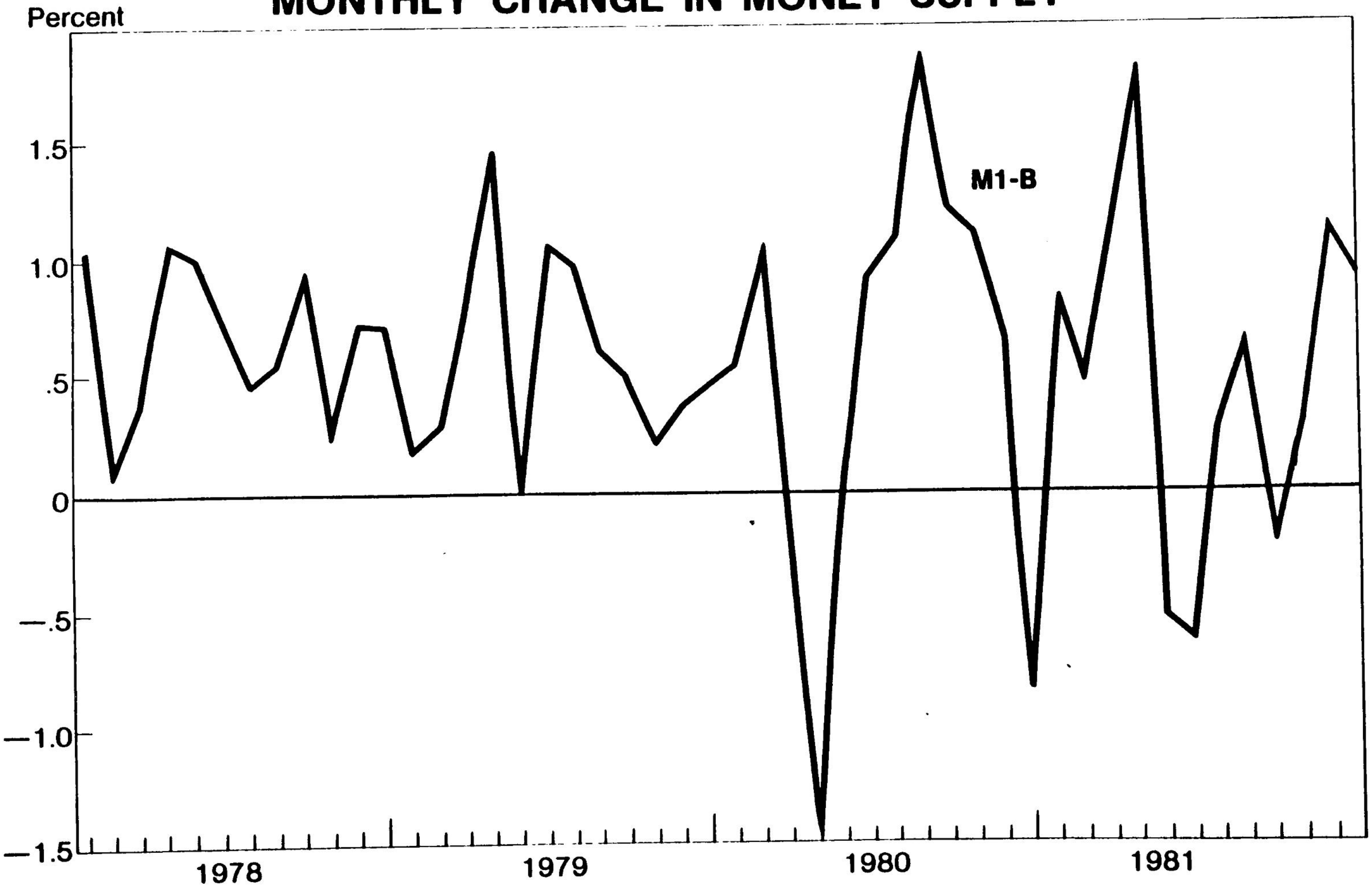
We are hopeful that the improved tax base from higher employment, income and property values in the Zones will more than compensate local governments for the services they provide. Most important, we are certain these economic gains will improve the incomes and job prospects of those now residing in these disadvantaged areas.

M_1 VERSUS TARGET RANGE*



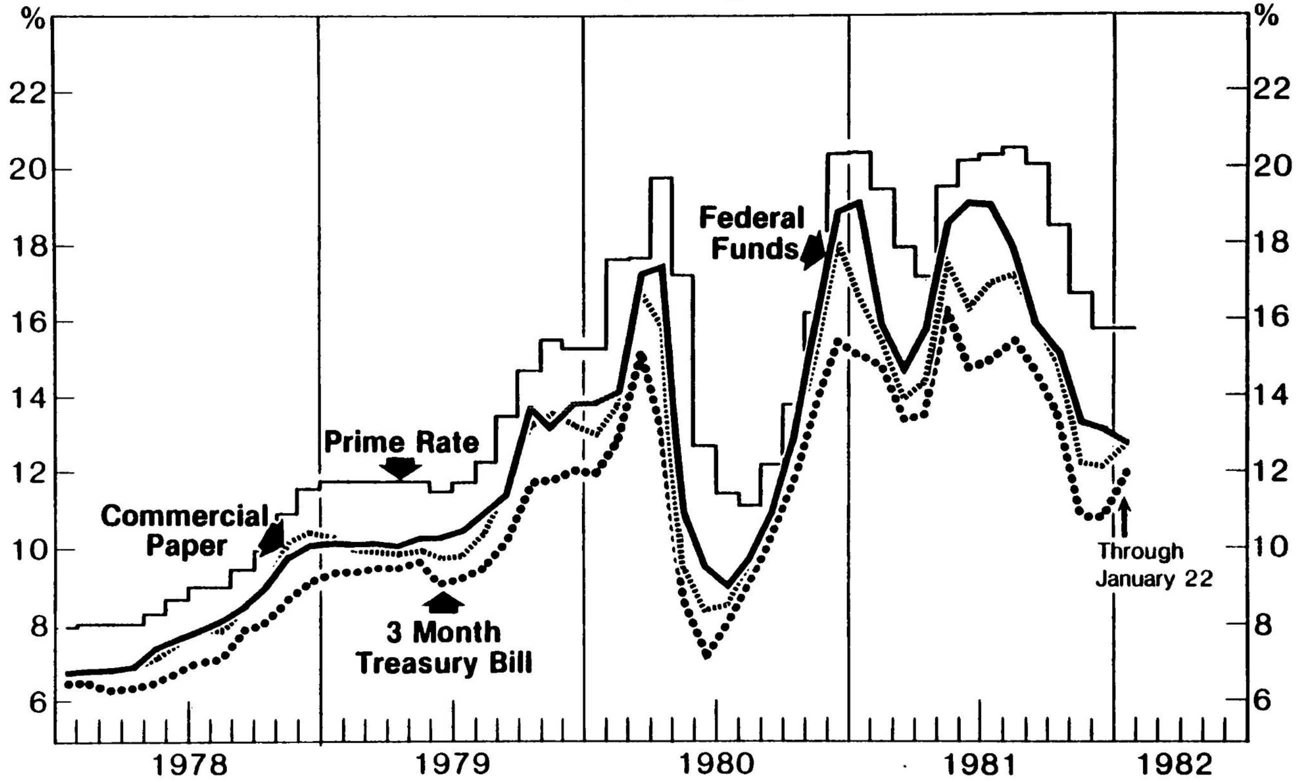
*Weekly Averages - Seasonally Adjusted

MONTHLY CHANGE IN MONEY SUPPLY



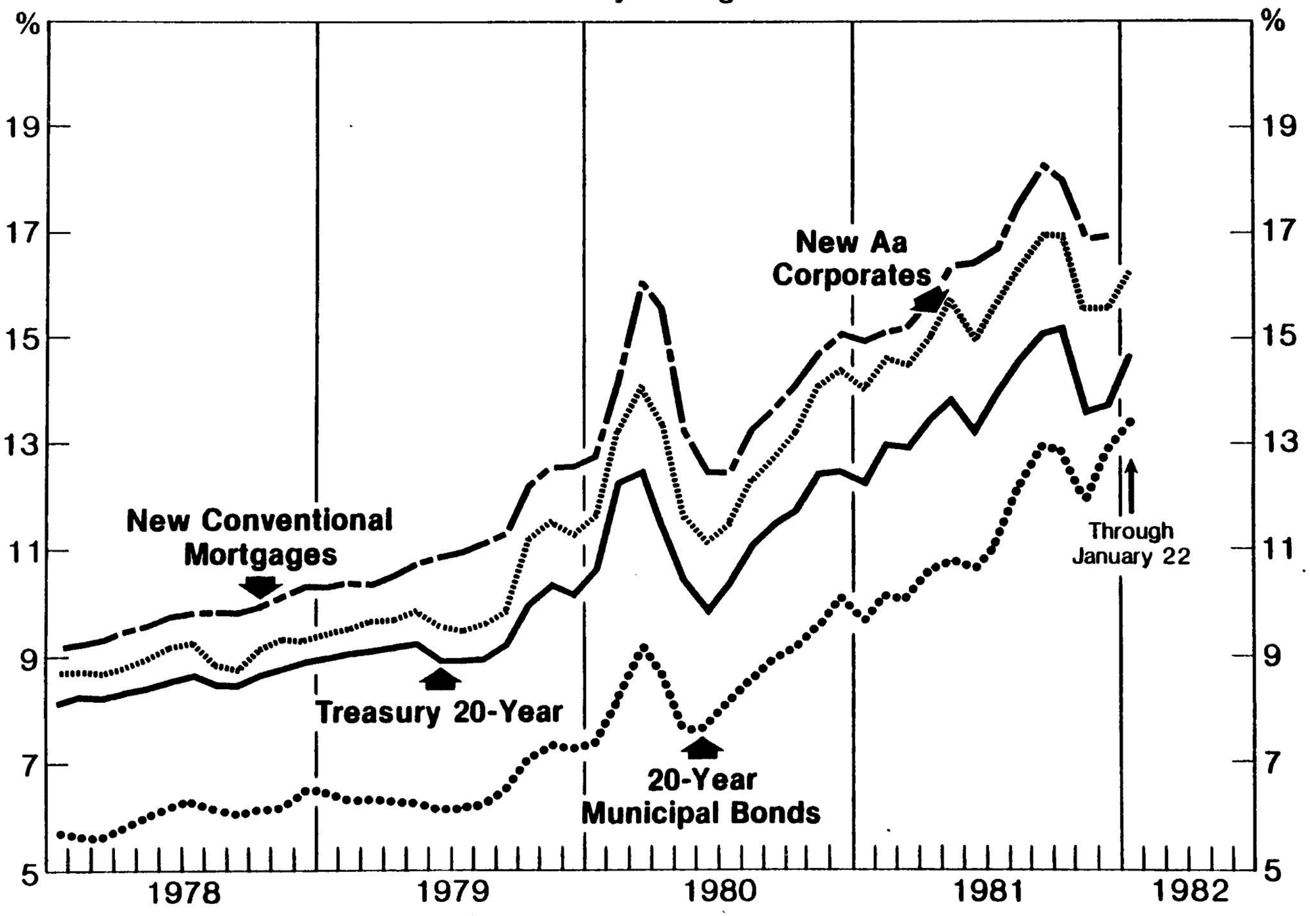
SHORT TERM INTEREST RATES

Monthly Averages



LONG MARKET RATES

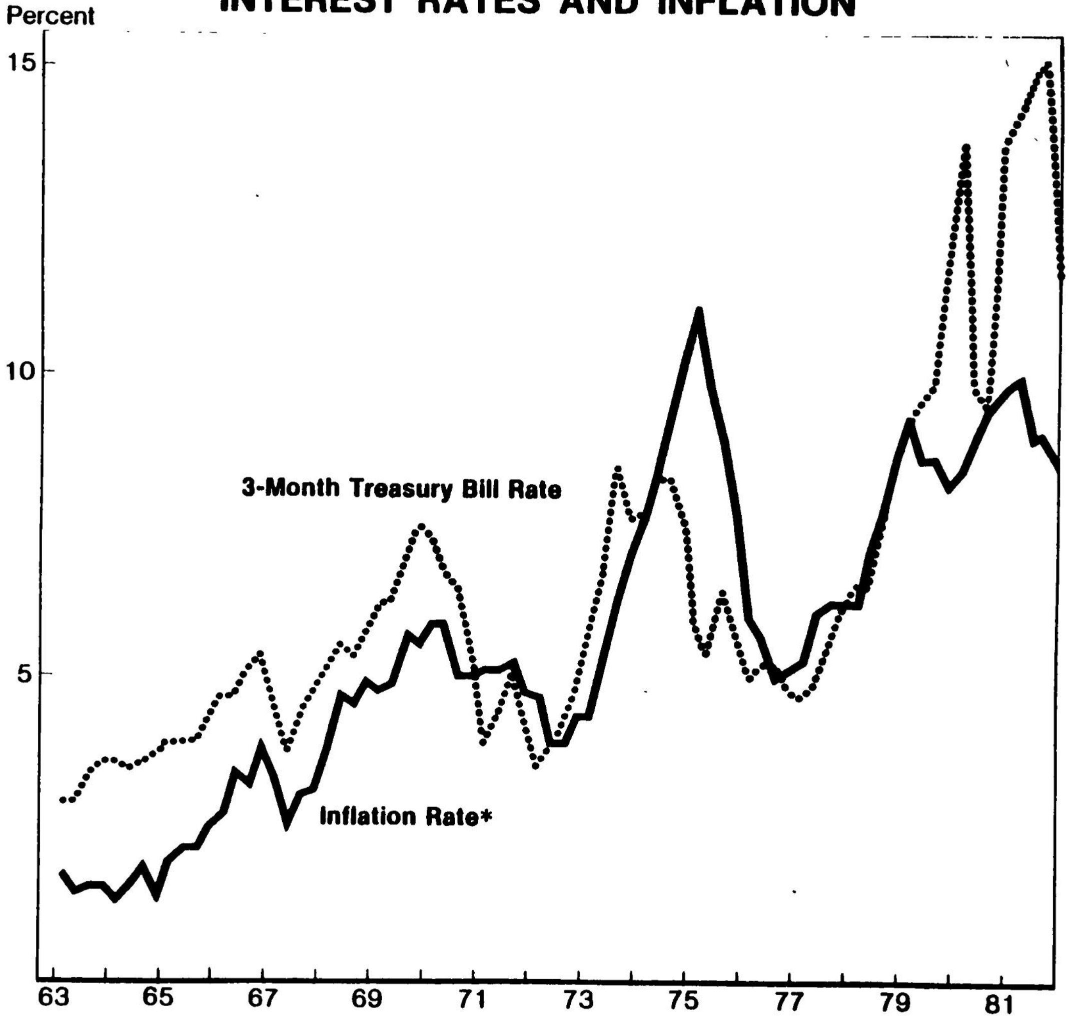
Monthly Averages



Office of the Secretary of the Treasury
Office of Government Financing

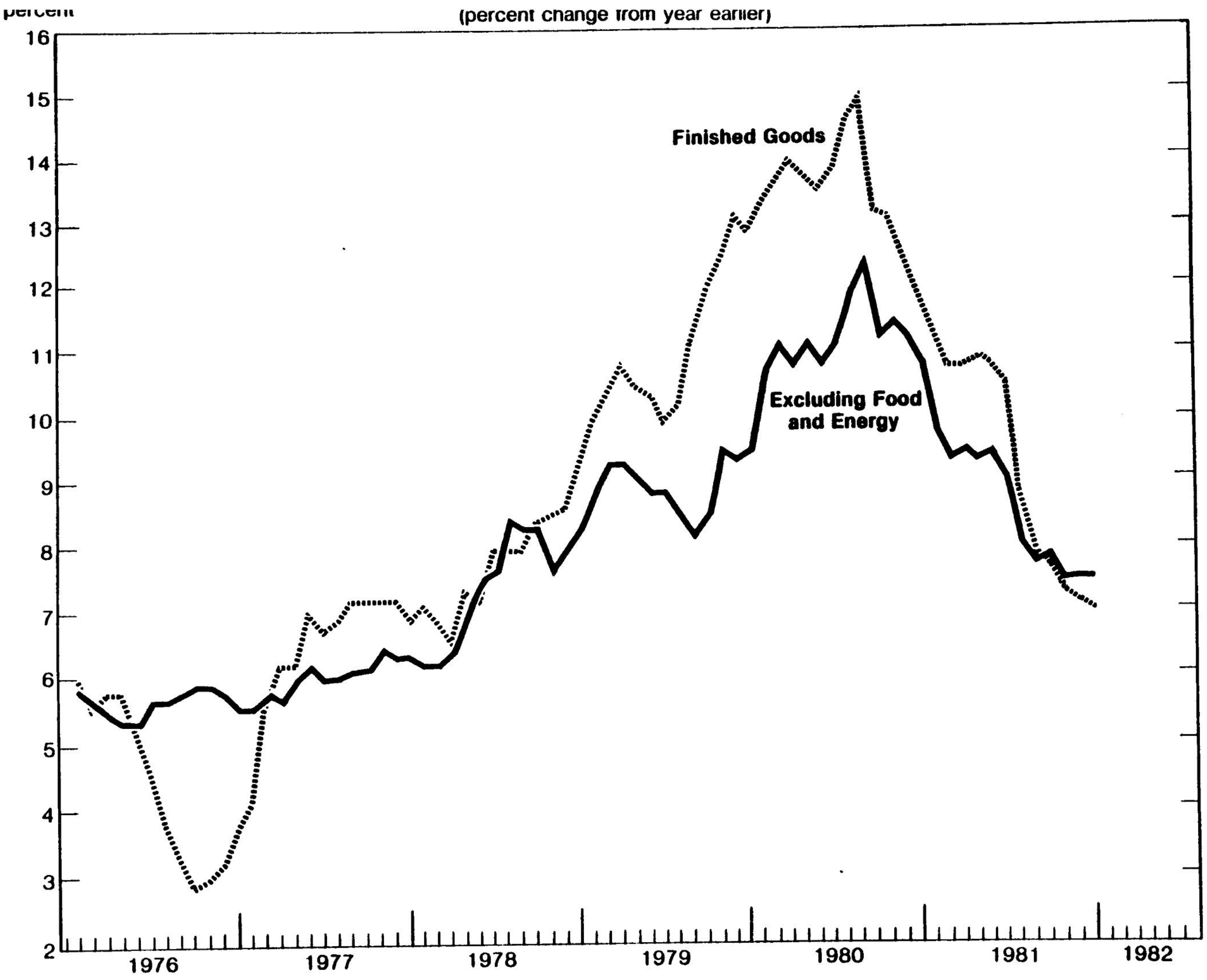
January 26, 1982-8

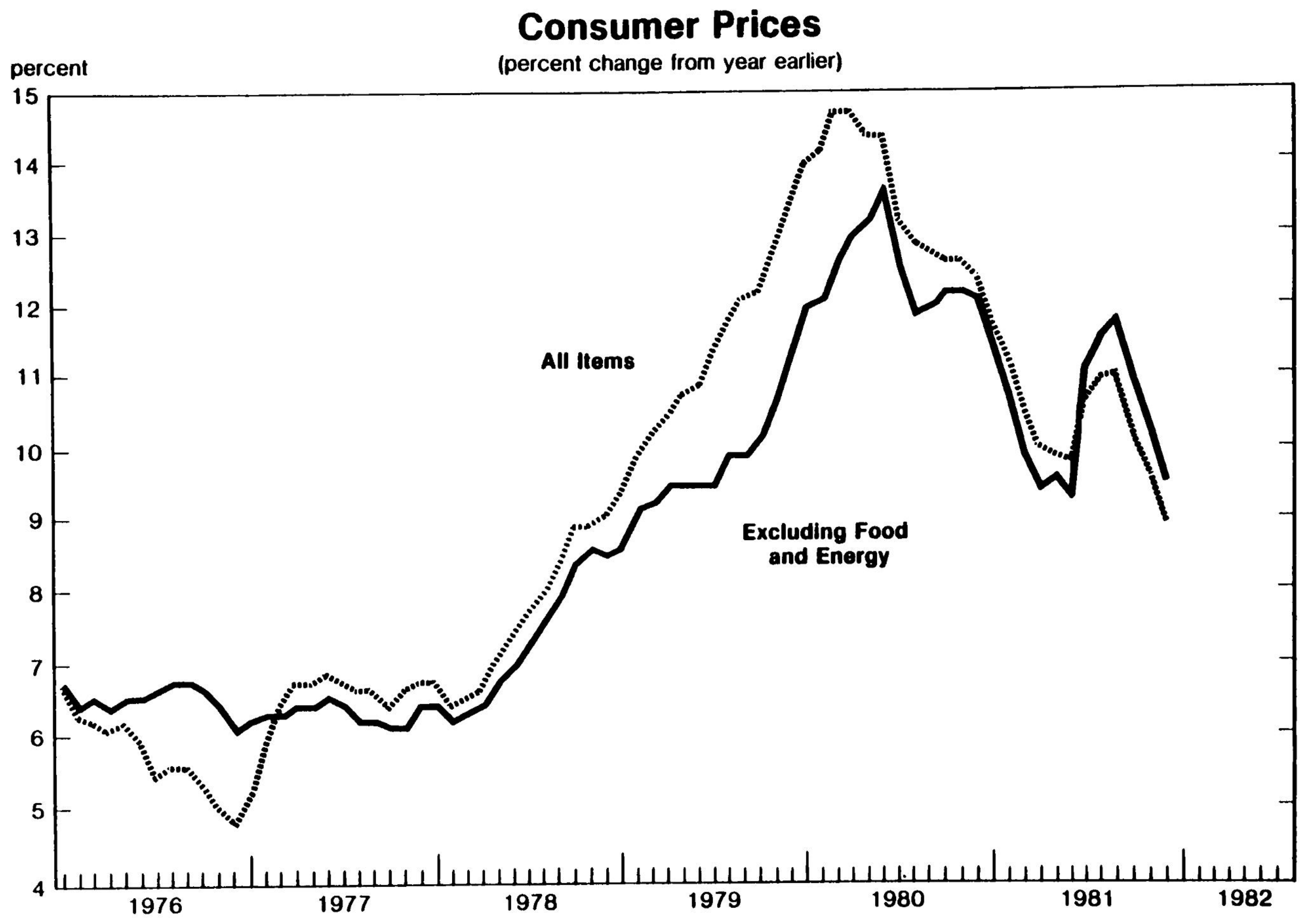
INTEREST RATES AND INFLATION



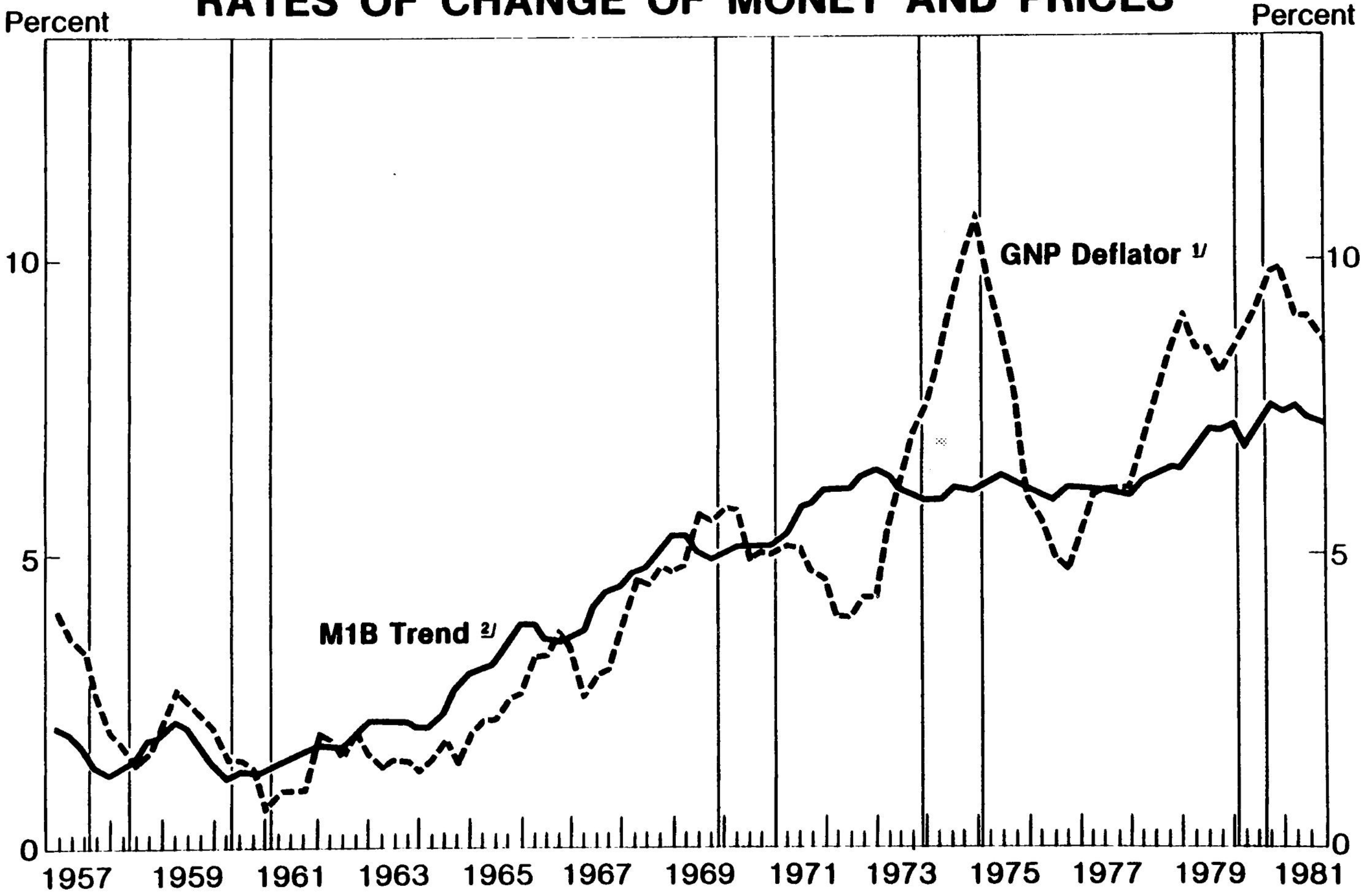
* Growth from year earlier in GNP deflator.
Plotted quarterly.

January 27, 1982 A159


percent
(percent change from year earlier)
16
15
14
13
12
11
10
9
8
7
6
5
4
3
2
Finished Goods
Excluding Food
and Energy
1976
1977
1978
1979
1980
1981
1982


Consumer Prices
(percent change from year earlier)
percent
15
14
13
12
11
10
9
8
7
6
5
4
All Items
Excluding Food
and Energy
1976
1977
1978
1979
1980
1981
1982

RATES OF CHANGE OF MONEY AND PRICES



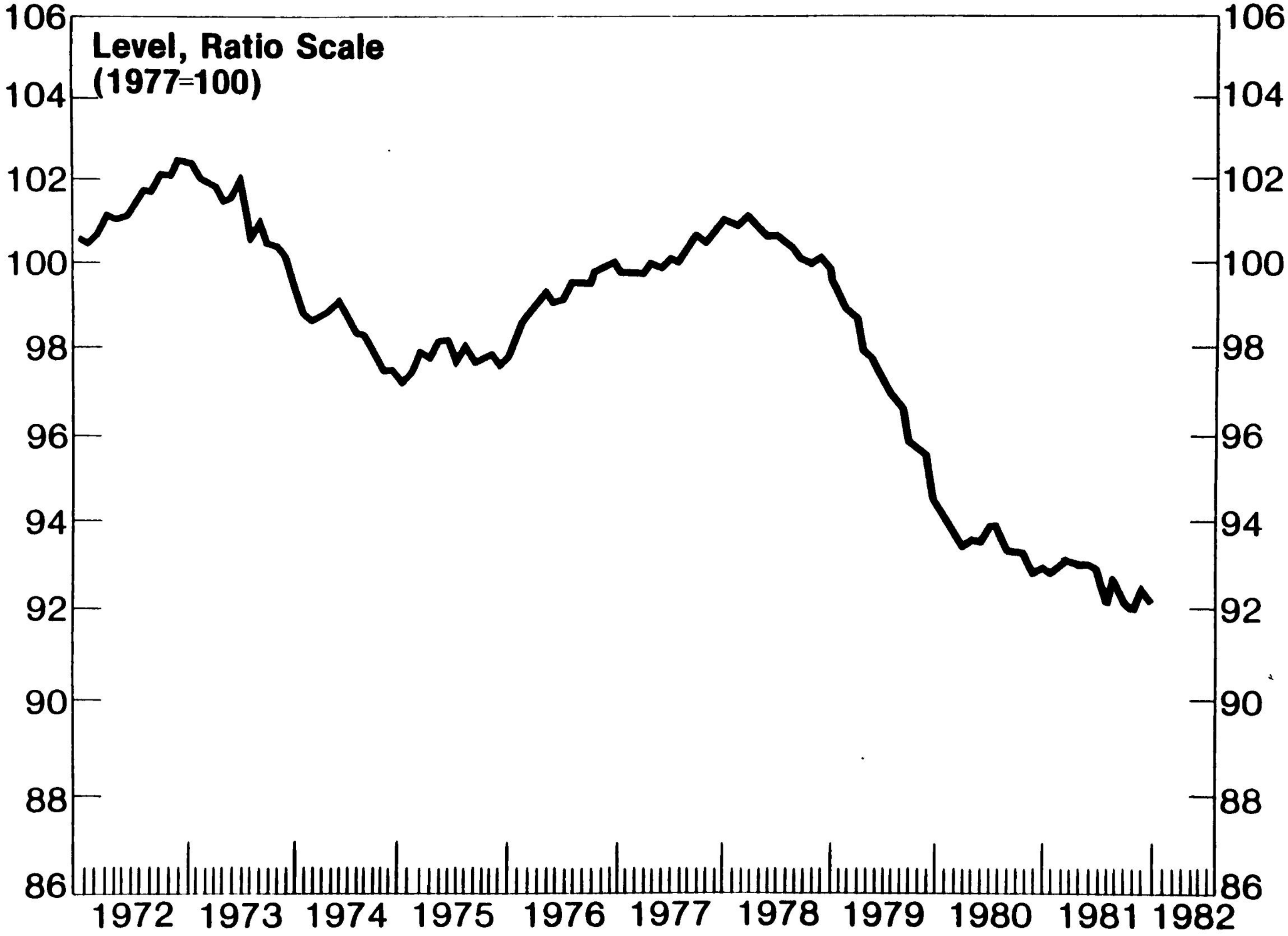
1/ Four-quarter rate of change;

2/ Twenty-quarter rate of change; data prior to 1st quarter 1964 are M1.

Latest data plotted: 4th quarter

January 27, 1982-A164

Total Private Nonfarm Economy, 1977 Dollars



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TALKING POINTS
FOR THE
FINANCING PRESS CONFERENCE
January 27, 1982

Before I disclose the specifics of the February refunding package and the projections of cash needs for the next two quarters, I would like to mention several other debt management matters.

First, the Treasury submitted legislation to the Congress yesterday to repeal the 4-1/4 percent interest rate ceiling on Treasury bond issues. Presently, the Treasury may issue up to $70 billion of bonds, which have over 10 years to maturity, without regard to the 4-1/4 percent ceiling. We have used $67-1/2 billion of that authority, and the quarterly financing that we are announcing today will use up the remaining $2-1/2 billion. We are hopeful that the Congress will act promptly on this legislation in order to permit the Treasury to continue to issue bonds, particularly during this current period of heavy financing requirements.

I would also like to note that the Treasury is continuing to study possible changes in its procedures for selling securities. As we announced last week, we are considering more efficient ways of making securities available to smaller investors, possibly through greater use of banks or other private financial institutions, but we have not completed our studies and we have nothing new to announce on that matter today.

Finally, I am happy to announce that Secretary Regan sent to the Congress yesterday legislation to remove the interest rate ceiling on Savings Bonds. This will enable the Treasury to issue the new, market-based variable rate Savings Bonds described by Secretary Regan last month. We are urging prompt action by the Congress.

The new bond will strengthen the Savings Bonds Program by assuring savings bond holders a fair return regardless of movements in market interest rates. A healthy Savings Bonds program will contribute to this Administration's objectives of encouraging individual savings and will also help to reduce the pressure on the market from our heavy borrowing requirements

On that note, I would now like to turn to the terms of our regular February quarterly refunding. I will also discuss the Treasury's financing requirements for the balance of the current quarter and our estimated cash needs for the April-June quarter.

1. We are offering $10.0 billion of securities to refund $4.3 billion of publicly-held coupon securities maturing on February 15 and raise approximately $5.7 billion of new cash.

The three securities are:

--First, a 3-year note in the amount of $5.0 billion maturing on February 15, 1985. This note will be auctioned on a yield basis on Tuesday, February 2. The minimum denomination will be $5,000.

--Second, a 10-year note in the amount of $2.5 billion maturing on February 15, 1992. This note will be auctioned on a yield basis on Wednesday, February 3. The minimum denomination will be $1,000.

--Third, a 29-3/4-year bond in the amount of $2.5 billion, which will be a reopening of the 14 percent bond maturing on November 15, 2011 and callable beginning November 15, 2006. This bond will be auctioned on a price basis on Thursday, February 4. The minimum denomination will be $1,000.

On each of the three issues, we will accept noncompetitive tenders of up to $1,000,000.

2. For the current January-March quarter, we estimate a net market borrowing of $41-1/4 billion, assuming a $10 billion cash balance at the end of March.

3. Including this refunding, we will have raised $18.8 billion in marketable borrowing. This was accomplished as follows:

--$1.8 billion of new cash from the 20-year, 1-month bond which settled January 6.

--$3.5 billion of new cash from the 7-year note which settled January 13.

--$1.6 billion of new cash from the 2-year note settling February 1.

--$.6 billion of new cash from the 52-week bill settling January 28.

--$5.7 billion of new cash from weekly bills, including the bills announced yesterday.

--$5.7 billion of new cash from the February refunding.

The remaining net financing requirement of about $22-1/2 billion could be accomplished through sales of regular weekly and monthly bills, a note in early March in the 5-year maturity range, additions to upcoming 2- and 4-year note maturities, and cash management bills.

Our net market borrowing need in the second quarter of calendar year 1982 is currently estimated in the range of $10 to $15 billion, assuming a $15 billion cash balance at the end of June. We may wish to have a somewhat higher cash balance than $15 billion on June 30, depending upon the course of the economy and market conditions in the second quarter and our revised estimates of our borrowing needs at that time.

GENERAL AND TECHNICAL EXPLANATIONS
OF
TAX REVISIONS
AND
IMPROVED COLLECTION AND ENFORCEMENT PROPOSALS

Announced in the President's
State of the Union Message
January 26, 1982

Department of the Treasury
Released: February 26, 1982

CONTENTS

COMPLETED CONTRACT METHOD OF ACCOUNTING

General Explanation

Current Law

Under present law, taxpayers may elect to use either the completed contract method or the percentage of completion method of accounting for long-term contracts, that is, contracts that extend beyond a single tax year. Common examples of such contracts are those for the construction of buildings, highways, dams and other facilities and for the custom manufacturing of aircraft, ships and heavy industrial machinery.

Under the completed contract method, income derived from long-term contracts is not recognized for tax purposes until the taxable year in which the contract is completed. A taxpayer may use the completed contract method even though payments are received throughout the course of a contract and even though products may have been delivered to the purchaser and placed in service. According to the principle of completed contract accounting, the contractor's deductions for all costs properly allocable to a long-term contract are also delayed until the income is realized. However, present regulations allow certain of these costs to be deducted currently.

Current regulations provide the following three rules for determining the tax treatment of costs allocable to a long-term contract:

1. Direct material costs and direct labor costs must be allocated to the long-term contract and deferred until completion of the contract.

2. Certain enumerated indirect costs must also be allocated to long-term contracts, and deferred until completion of the contract. Examples of such indirect costs are indirect labor, utilities, rental payments for equipment or facilities, and book depreciation of capital equipment.

3. Other indirect costs, at the election of the taxpayer, may be treated as period costs and deducted currently. Such costs include:

Marketing and selling expenses, including bidding expenses;
Advertising expenses;
Other distribution expenses;
Interest;
General administrative expenses;
Research and development costs;
Certain losses;

Pension and profit-sharing contributions;
The excess of cost recovery allowances over book depreciation on capital assets;
The excess of percentage depletion over cost depletion;
Depreciation and amortization on idle equipment and facilities;
Income taxes attributable to long-term contracts;
Costs attributable to strikes, rework labor, scrap and spoilage; and
Compensation paid to officers attributable to long-term contractor's activities as a whole.

An alternative method of accounting for long-term contracts permitted by the regulations is the percentage of completion method. Under this method, that portion of income realized from a contract that corresponds to the percentage of the entire contract completed during the year is included in gross income for the taxable year. Expenses are deducted as incurred. Because the percentage of completion method recognizes that income is earned over the course of a long-term contract and because it provides for a better matching of income and expense, it yields a better measure of income than does the completed contract method.

Reasons for Change

The completed contract method permits income to be deferred for tax purposes long after payments are received and long after income is deemed earned according to standard accounting practices. The use of the completed contract method has led to large and unintended tax benefits. For instance, many contractors, including virtually all in the defense and aerospace industries, can substantially reduce their current tax liability through the use of the completed contract method. This is accomplished by deferring all income from a contract until the contract is completed (although progress payments are received throughout the term of the contract), while taking allowable deductions for indirect costs currently. In the case of certain re-order or change order agreements which taxpayers treat as part of the original contract, the period of deferral can be as long as 10, 15 or even 20 years.

Because of inflation and the increasing size of new contracts, the deductible costs will often exceed the income to be recognized (from old contracts) in any one year. The result has been that many taxpayers, while enjoying substantial economic profits and reporting these profits to shareholders and creditors, have been reporting large losses for tax purposes. These tax losses may shelter other income from taxation. In at least one case, the losses have been sufficient to eliminate the taxpayer's accumulated earnings and profits, enabling that taxpayer to make tax-free distributions to shareholders.

Similar problems could result if taxpayers were permitted to use an "accrual shipment" or "accrual acceptance" method of accounting in conjunction with normal inventory accounting rules for long-term manufacturing contracts. Under these methods, taxpayers would defer income, but deduct certain costs currently in a manner similar to that provided by the completed contract method and, in addition, could elect the further tax deferral benefits of the Last-In, First-Out inventory accounting method. However, this could occur only when the product manufactured constituted inventory.

Another problem resulting from current long-term contracts rules arises because certain construction contracts and contracts for the sale of heavy equipment include provisions for engineering or assembly services to take place after delivery of parts and materials. Many taxpayers obtain additional deferral by maintaining that contracts are not complete until such services have been rendered. This is done even when full payment has been received upon delivery of the parts and materials.

Proposal

To resolve problems arising from the use of the completed contract method, the following regulatory and legislative actions are proposed:

Regulatory Proposal. The current regulations regarding accounting for long-term contracts will be amended in several respects:

First, the regulations will be changed to require that, in the case of contracts accounted for by the completed contract method, all but a limited list of indirect costs will be allocated to long-term contracts and deferred until such contracts are completed.

Second, the regulations will be amended to clarify when an agreement, or series of agreements, must be regarded as more than one contract.

Third, to prevent certain taxpayers from attempting to circumvent the intent of the changes in the completed contract rules through the use of an accrual shipment or accrual acceptance method of accounting in conjunction with inventory accounting rules, the current regulations will be amended as follows:

1. In the case of taxpayers using the accrual shipment and accrual acceptance methods of accounting for multi-unit contracts, the regulations will specify that income accrues upon the shipment or acceptance of the various units and not upon the final unit.

2. In the case of taxpayers entitled to use an inventory method for a long-term contract, such taxpayer must use the costing rules set forth in the completed contract regulations.

Legislative Proposal. The legislative proposal (1) repeals the completed contract method and (2) provides that taxpayers must elect to use either the percentage of completion method or the progress payment method of accounting for long-term contracts. Under the progress payment method, most costs are allocated to long-term contracts and deferred until the taxpayer has a right to receive payment under a contract. At the time the right to payment accrues the taxpayer may deduct the total of the current and previously unclaimed costs allocated to a contract, up to the amount of the accrued payment. If the accrued payments exceed costs, the taxpayer would recognize the excess as income. Certain borrowings in lieu of payment are treated as payments.

Conceptually, the percentage of completion method is the method of accounting for long-term contracts that best reflects the taxpayer's income. This method will continue to be available for those who choose to use it. However, it is recognized that requiring this method in all cases may be difficult to administer and burdensome to taxpayers. As a practical matter, most taxpayers will choose to account for long-term contracts on the progress payment method. Compared with the completed contract method, the progress payment method has several advantages. It ensures that taxpayers who receive or have the right to receive a cash profit will include that profit in income; thus, it eliminates the most serious accounting distortions arising from the use of the completed contract method. However, when payments do not exceed costs, income earned on a contract is deferred until the contract is complete. In some cases, taxpayers will not recognize income from a contract until the contract is complete. Thus, the progress payment method might not affect a taxpayer's cash flow as severely as would the percentage of completion method.

Effects of the Proposal

The economic effect of both the legislative and regulatory proposals can be illustrated by a numerical example. A manufacturing corporation that spends $1,000,000 in each of five years to produce inventory that is sold for $1,200,000 each year would pay a 46 percent rate of tax on $200,000 of annual net income, or $92,000 in taxes each year. By contrast, a contractor producing a similar product for special order and using the completed contract method could also receive $200,000 of net income each year but pay no taxes until the fifth year when tax of $460,000 would be due on the entire profit of $1 million.

A company that must pay tax of $92,000 annually for five years is at a substantial disadvantage to one paying $460,000 at the end of five years. If the contractor's after-tax borrowing cost were 10 percent, that contractor would be able to charge 2.1 percent less for his product and earn the same return on invested capital as a manufacturer unable to use the completed contract method. If, as in the example, these two taxpayers charged the same price, the reduced tax cost of the completed contract method would result in 15 percent higher profits for the contractor.

The proposal reduces the tax advantage available to taxpayers who are able to use the completed contract method. It is estimated that 50 percent of the output affected by this proposal is produced in defense industries, 35 percent in the construction industry, and that most of the remaining 15 percent is produced by the heavy equipment industry. Costs in the affected industries will be increased by both the regulatory changes and the legislation, since both changes will reduce opportunities for deferring tax payments on the income from long-term contracts.

The legislative and the regulatory proposals would be effective for taxable years beginning after December 31, 1982. However, the legislative proposal would provide that taxpayers may continue to use existing completed contract rules for contracts entered into on or before the date of release. The legislation will also specify that a cut-off method be used to account for the transition between the old and new rules for existing contracts not subject to the grandfather provisions. Under the cut-off method, a taxpayer would account for income earned and costs incurred after the effective date of the proposal under the new rules and would make no adjustment for the prior treatment of these items. The regulatory proposal will similarly grandfather contracts entered into on or before the date of release for taxpayers who elect the cut-off method to account for the required change in treatment of period costs.

<u>Revenue Estimate</u>

Fiscal Years					
1982	1983	1984	1985	1986	1987
($ billions)					
*	1.9	4.4	4.6	4.1	4.0

* $50 million or less.

COMPLETED CONTRACT METHOD OF ACCOUNTING

Technical Explanation

Summary of the Proposal

Regulatory Proposal

Amendments to the regulations will change the treatment of certain indirect costs incurred by taxpayers who engage in long-term contracts. In general, the list of costs allocable to long-term contracts is expanded, while the list of costs which can be deducted currently is reduced. The proposed amendments provide that a taxpayer using an inventory method of accounting for a long-term contract must use the same costing rules as taxpayers using the completed contract method. The regulations include rules which clarify when a long-term contract will be severed or aggregated. Additional rules clarify when a long-term contract will be considered "completed." Rules also make clear that under an accrual method, income from a multi-unit contract accrues when each item under the contract is shipped, delivered, accepted, or when title to each item passes to the purchaser.

Legislative Proposal

Section 451 of the Internal Revenue Code will be amended to provide that in the case of long-term contracts as defined by the Secretary in regulations, items of gross income shall be recognized in accordance with one of two methods of accounting, (1) the percentage of completion method or (2) the progress payment method.

Detailed Description

A. Regulatory Proposal

Treatment of Indirect Costs

Under current regulations (section 1.451-3(d)), certain indirect costs incurred by a taxpayer in the performance of particular long-term contracts must be allocated to such contracts. However, other costs (such as general and administrative expenses, interest, research and experimental expenses, accelerated depreciation, pension costs and other employee benefits) are treated as costs which are not required to be allocated to long-term contracts without regard to whether such costs are incurred in the performance of particular long-term contracts. These cost classification rules distort the timing of the recognition of income and deductions with the result that the completed contract method of accounting does not clearly reflect income.

Accordingly, the regulations under section 1.451-3(d) as amended will require that all indirect costs that directly benefit the performance of long-term contracts and an appropriate part of all other indirect costs must be allocated to long-term contracts. Only the following expenses are excepted from this general rule:

(a) General marketing, selling and advertising expenses;

(b) Bidding expenses incurred in the solicitation of contracts not awarded to the taxpayer;

(c) Research and experimental expenses neither directly attributable to particular long-term contracts in existence at the time such expenses are incurred nor incurred under any agreement to perform such research or experimentation;

(d) Losses under section 165 and the regulations thereunder;

(e) Depreciation and amortization on idle equipment and facilities;

(f) Income taxes attributable to income received from long-term contracts;

(g) Pension contributions to the extent that they represent past service costs; and

(h) Costs attributable to strikes.

2. <u>Requirement that New Costing Rules be Used for All Long-Term Contracts</u>

Under existing regulations, taxpayers are not required to use a long-term contract method to account for contracts meeting the definition of a long-term contract. Taxpayers engaging in long-term contracts may use inventory methods of accounting, assuming the goods they manufacture constitute inventory. The proposal will amend section 1.471-11 of the regulations to provide that taxpayers who are entitled to use an inventory method must nevertheless use the rules for allocating direct and indirect costs set forth in the completed contract regulations. A similar rule will be incorporated in the regulations under section 451 of the Code.

3. <u>Severing and Aggregating Long-term Contracts</u>

Current regulation section 1.451-3(e) provides that:

"Several agreements will not generally be treated as a single contract unless the several agreements would be

> treated as one contract under customary commercial practice in a taxpayer's trade or business or unless there is no business purpose for entering into several agreements rather than one agreement. An example of a factor which is evidence that two contracts entered into between the same parties should be aggregated is that one of the contracts would not have been entered into containing the terms agreed upon but for the entering into of the other contract."

This language is intended to apply when, for instance, a taxpayer prices two or more agreements using average costs and the costs of initial production are higher than the costs of later production. However, some taxpayers have interpreted this regulation to apply to two or more independently priced contracts provided that the taxpayer anticipated future contracts at the time the first contract was entered into.

The proposal will amend section 1.451-3(e) to provide that two or more agreements which are priced independent of one another will not be treated as one contract.

Under the proposal, regulation 1.451-3(e) is further amended to specify that if an agreement is amended (as by the exercise of an option or the issuance of a "change order") to increase the number of items to be supplied under the agreement, such modifications shall be treated as a separate contract or as several separate contracts.

4. <u>Other Clarifying Provisions</u>

Regulation section 1.446-1(c) will be amended to provide that taxpayers using an accrual method of accounting for multi-unit contracts must account for sales of the various items when each item is delivered or shipped, or when title to individual items passes to the customer.

The regulations as amended will also provide rules under section 1.451-3 that specify when a contract will be considered to be "completed."

The proposed amendments will provide that a contract will be considered complete without regard to any term of the contract providing for additional compensation contingent upon the continued successful performance of the subject matter of the contract after the subject matter of the contract has been initially accepted by the purchaser (for example, an incentive bonus payable if a satellite remains in operation for twenty months after it is placed in orbit). Further, a contract will be considered complete without regard to any obligation on the part of the contractor to provide replacement parts or to supervise installation or assembly of the subject matter of the contract.

B. Legislative Proposal

A new Code section 451(f) entitled "Special Rule for Accounting for Long-term Contracts" will provide that in the case of long-term contracts, as defined by the Secretary in the regulations, taxpayers must use either the progress payment method of accounting as defined in new section 451(g) or the percentage of completion method.

Under the progress payment method, a taxpayer must take all payments into income when the right to such payment accrues. The term "payments" for this purpose means all amounts the taxpayer has a right to receive under the contract. A taxpayer will not be considered to have received or to have a right to receive any amount subject to retainage for this purpose. However, certain borrowings in lieu of payment will be treated as payment. For instance, loans from the purchaser to the contractor or loans secured by the contract will be treated as progress payments. A special rule provides that certain advance payments received or accrued before work on a contract has commenced will be treated as having been received in equal amounts over a 12-month period beginning with the month it is received or accrued. Taxpayers who receive advance payments that constitute a significant percentage of the total contract price may request to spread that payment over a longer period.

In general, all costs are allocated to contracts and deducted only when the taxpayer has a right to receive payment under the contract and, then, only to the extent of such payment. The only exception to this rule is with respect to the following costs which will be treated as period costs:

(a) General marketing, selling and advertising expenses;

(b) Bidding expenses incurred in the solicitation of contracts not awarded to the taxpayer;

(c) Research and experimental expenses neither directly attributable to particular long-term contracts in existence at the time such expenses are incurred nor incurred under any agreement to perform such research or experimentation;

(d) Losses under section 165 and the regulations thereunder;

(e) Depreciation and amortization on idle equipment and facilities;

(f) Income taxes attributable to income received from long-term contracts;

(g) Pension contributions to the extent that they represent past service costs; and

(h) Costs attributable to strikes.

The determination of whether a taxpayer must recognize income for a particular year is made on a contract by contract basis. Thus, taxpayers may not offset income from one contract with costs of another contract. If, for example, a taxpayer has two contracts, Contract A and Contract B, and progress payments exceed costs with respect to Contract A but not with respect to Contract B, the taxpayer will recognize income from Contract A, even if the excess costs from Contract B equal or exceed the income recognized from Contract A.

Under the progress payment method, income will be recognized during the course of a particular contract only when payments received or accrued with respect to that contract exceed the total of current and previously unclaimed costs allocated to that contract. Losses will be recognized only if costs incurred during a taxable year exceed the total amount the taxpayer has a right to receive under the contract.

Effective Date

The regulatory proposal and the legislative proposal will be effective for taxable years beginning after December 31, 1982. However, the legislative proposal will provide that taxpayers may continue to use the current long-term contract accounting rules for contracts entered into on or before the date of release. The regulatory proposal will provide that taxpayers who elect the cut-off method (explained below) may continue to use the current period cost rules for contracts entered into on or before the date of release. Costs that are deducted in taxable years beginning after December 31, 1982, and that are required to be capitalized under the new rules will be treated as an item of tax preference subject to the minimum tax.

Taxpayers required to change their method of accounting pursuant to the regulatory proposal are permitted to elect one of three transition rules. Under the first rule, a taxpayer is required to take any section 481 income adjustment resulting from the change into account in the year of change. However, such a taxpayer will be able to treat the change as one not initiated by the taxpayer and could, thus, retain any "pre-54 balances." Under the second rule, a taxpayer is permitted to spread any adjustment necessitated by the change in costing rules over the lesser of 10 years or the number of years the taxpayer has been on its current method. However, to the extent a portion of the adjustment is attributable to a contract which is completed during a taxable year such portion must be taken into account in that taxable year. The third rule provides that taxpayers may elect to use the cut-off method to account for the required change. Under the cut-off method, a taxpayer will treat costs incurred and income realized after the effective date of the proposal under the new rules. Taxpayers required to change their method of accounting pursuant to the legislative proposal will use the cut-off method to account for the change.

BUSINESS ENERGY TAX INCENTIVES

General Explanation

Current Law

Under current law, a variety of tax incentives are available to encourage energy conservation and use of renewable energy.

Investment credits are available in addition to the regular 10 percent investment credit for qualified energy property. The energy investment credit rate is 15 percent for solar and wind investments, geothermal equipment, and ocean thermal equipment; 11 percent for low head hydroelectric equipment; and 10 percent for other qualifying investments. Thus, the total investment credit for firms purchasing qualified energy property varies in most cases from 20 to 25 percent of the cost of equipment.

The major categories of property eligible for a supplemental 10 percent energy credit are alternative energy property (generally property that uses alternative substances as a fuel or as a feedstock), specially defined energy property (a list of specified investments designed to increase the energy efficiency of existing agricultural, commercial, and industrial processes), cogeneration equipment, recycling equipment, shale oil equipment, equipment for producing natural gas from geopressured brine, biomass equipment, and intercity buses.

Most of the business energy investment credits expire on December 31, 1982. However, the credits for solar, wind and geothermal equipment, ocean thermal equipment, biomass equipment, low head hydroelectric equipment, and intercity buses expire on December 31, 1985. In addition, special rules allow business firms to claim credits on alternative energy property until 1990 for expenditures on projects for which an affirmative commitment was made before the expiration date of the credit.

Other energy tax incentives provided to business are tax-exempt financing, fuel production credits, and the excise tax exemption for alcohol fuels.

Tax-exempt financing is sometimes available for certain low head hydroelectric facilities, for solid waste disposal facilities, and for certain property used to produce energy from renewable energy sources.

A credit of $3 (in 1979 dollars) for each barrel of oil equivalent, in BTUs, is available for fuel produced from a nonconventional source. Qualified fuels include shale oil and tar sands oil; natural gas produced from geopressured brine, Devonian shale, coal seams, a tight formation or biomass; synthetic fuel produced from coal; qualifying processed wood fuel; and steam produced from agricultural waste. Except for credits with respect to processed wood and steam, these credits become available when the price of a barrel of oil falls below $29.50 (in 1979 dollars). A similar rule applies to natural gas. These credits do not expire until 2001.

Finally, current law provides an exemption from the 4 cents per gallon Federal excise tax on gasoline, diesel fuel, and other motor fuels for gasohol which is at least 10 percent alcohol. This amounts to a subsidy of 40 cents per gallon ($16.80 per barrel) for alcohol producers. In cases where the tax exemption for gasohol does not apply, a tax credit is provided, equal to 40 cents per gallon of at least 190 proof, and 30 cents per gallon for alcohol of at least 150 but less than 190 proof.

Reasons for Change

At the time the energy tax incentives were enacted, price controls and supply allocations were in effect on both crude oil and natural gas and there was substantial resistance to decontrol. Prices of both oil and natural gas paid by consumers were substantially below replacement costs, as reflected by the price of imported oil. Oil imports were growing at the same time that domestic consumption was being subsidized and domestic production discouraged.

Because of price controls, business firms had an insufficient incentive to invest in energy-conserving capital or in alternative energy sources (other than oil or gas), or to use alternative fuels, such as fuels derived from alcohol, wood, or biomass. Therefore, in the absence of free market prices, an economic rationale existed for tax incentives for conservation and renewable energy.

However, since enactment of the credits, crude oil prices have been decontrolled. In addition natural gas prices are being decontrolled under the National Gas Policy Act. As a result, the credits, whatever their original justification, are no longer needed because most firms confront the true replacement cost of energy and therefore have sufficient incentive to invest in energy conservation and renewable energy and to purchase alternative fuels without targeted tax incentives.

In general, tax incentives for specific investments are inconsistent with the Administration's philosophy of relying on markets to allocate resources efficiently and with its policy to rely on the market, rather than Federal management, to determine patterns of energy use. The Accelerated Cost Recovery System (ACRS), enacted as part of the Economic Recovery Tax Act, has removed tax impediments to business investment -- including investments now eligible for energy tax incentives -- without dictating firms' choices among investment alternatives.

In addition, the energy tax incentives distort the allocation of resources, encouraging firms to undertake investments that are uneconomic at current market prices, and to purchase higher cost fuels where a lower cost substitute is available. As a result, these incentives divert workers, capital, and initiative from more productive uses elsewhere in the economy and lower the net productivity of the capital stock.

Moreover, by reducing the cost of only some conservation measures, the incentives discourage other, potentially more efficient approaches. New inventions and refinements in old technology not covered by the subsidy are at a disadvantage in the market when the Federal government interferes to subsidize the competition.

Proposal

The business energy tax credits remaining after December 31, 1982 will be repealed. These include credits for solar, wind and geothermal equipment, ocean thermal equipment, biomass equipment, low head hydroelectric equipment, and intercity buses. The remaining business energy tax credits will be allowed to terminate on December 31, 1982, as provided under current law. The special provisions enacted in 1980 that allow State and local governments to issue tax-exempt bonds to finance low head hydroelectric facilities and facilities which produce steam or alcohol from solid waste, and certain State programs for energy conservation will be repealed. The fuel production credits will be repealed as will the exemption of gasohol from the Federal excise tax on motor fuels and the alcohol fuel tax credit.

The proposal generally will become effective on January 1, 1983. However, taxpayers subject to binding contracts to acquire or to construct energy property on the date of release will continue to qualify for all the credits available under current law. Qualified progress expenditures in 1982 for long-term projects (those with construction periods greater than two years) will be eligible for the credits for property placed in service after 1982. In addition, taxpayers with binding contracts to acquire or to construct long-term energy projects prior to January 1, 1983 will be eligible for credits until December 31, 1985. Finally, alcohol fuel producers will be eligible for a production credit of 40 cents per gallon of alcohol of at least 190 proof (30 cents for alcohol between 150 and 190 proof), until December 31, 1985, for production from capacity either in place or for which a binding purchase or construction contract had been signed by the date of release. After December 31, 1985, the credit will phase out by 10 cents per year.

Effects of Proposal

The proposal will affect primarily investments in unconventional technologies. All of the business energy investment tax credits, other than those for solar and wind investment, geothermal equipment, ocean thermal equipment, biomass equipment, low head hydroelectric equipment, and intercity buses, are scheduled to expire December 31, 1982. Consequently, the proposal does not affect many post-1982 investments in alternative energy property, specially defined energy property, cogeneration equipment, recycling equipment, shale oil equipment, and equipment for producing natural gas from geopressured brine. However, the proposal will affect some long-term projects in these categories by tightening the "affirmative commitment" rule that permits these expiring credits to be claimed after December 31, 1982, and, in some cases, as late as 1990 under current law.

The following examples illustrate the transition rules which will mitigate the effect of repeal on taxpayers who relied on current law.

Example 1. Taxpayer A signs a binding contract on January 11, 1982 to acquire solar energy property with a normal construction period of 13 months. The property is placed in service in February 1983. Taxpayer A is eligible to claim the energy tax credit with respect to the solar property in 1983, notwithstanding that the credit is repealed effective December 31, 1982, because of the pre-date of release binding contract.

Example 2. Taxpayer B signs a binding contract on December 10, 1982 to acquire alternative energy property with a normal construction period of 30 months. B makes qualifed progress expenditures in 1983, 1984 and 1985. The property is placed in service in June 1985. B may claim the energy tax credit with respect to the qualified progress expenditures because a binding contract for a long-term project was entered into prior to December 31, 1982 and the expenditures were made prior to December 31, 1985.

Example 3. Taxpayer C enters into a binding contract on December 23, 1982 to acquire alternative energy property with a normal construction period of 48 months. The property is placed in service in December 1986. C makes qualified progress expenditures in 1983, 1984, 1985 and 1986. C is eligible to claim the energy tax credit for qualified progress expenditures made prior to December

31, 1985, even though the property is placed in service in 1986, because the binding contact entered into prior to December 31, 1982 qualifies post-1982, pre-1986 expenditures, and the transition rule permits the credit for qualified progress expenditures prior to the date a credit expires, even if the property is placed in service after that date.

Example 4. In 1981, Taxpayer E acquired a facility which can produce up to 50,000 gallons per day of greater than 190 proof alcohol for blending with gasoline for producing gasohol. In addition, E signed a binding contract on January 1, 1982 to construct a second facility with a design capacity of 10,000 gallons per day. On April 1, 1982, E contracts for a third facility with a design capacity of 20,000 gallons per day. Both new facilities begin production in 1983.

From 1983 through 1985, E is eligible for the 40 cents per gallon production credit for 60,000 gallons per day. The 10,000 gallons per day of production in excess of 1982 capacity levels is eligible for the credit because E signed a contract before the date of release to acquire an additional 10,000 gallons per day of production capacity. After 1985, the 60,000 gallons per day of output are eligible for the reduced credit of 30 cents per gallon in 1986, 20 cents per gallon in 1987, and 10 cents per gallon in 1988.

Under current law, the business energy investment tax credits for solar and wind energy property, geothermal equipment, ocean thermal equipment, low head hydroelectric equipment, biomass equipment, and intercity buses are available through December 31, 1985. Eliminating the availability of energy credits for these investments on December 31, 1982 (subject to the transition rules) will increase Federal revenues by about $1.5 billion during Fiscal Years 1983-1987. Over 90 percent of this gain will result from elimination of the credits for biomass equipment and low head hydroelectric projects. Other qualifying property is not expected to generate significant investments even if the credits are retained.

An additional $0.3 billion of Federal revenue will be gained from changes in transitional rules affecting eligibility of coal and shale oil property, coke ovens, and cogeneration equipment purchased after December 31, 1982.

The revenue gain from repeal of the fuel production credits and tax-exempt financing for certain energy projects is expected to be less than $100 million.

At currently projected oil prices, it is unlikely there will be substantial production of alcohol fuels, even if the alcohol fuel credit and the alcohol fuel excise tax exemption are retained.

Alcohol fuel production from existing plants is likely to be decreased only slightly by the proposed phase out of the alcohol fuel tax incentives. The Federal revenue increase resulting from phasing out the subsidies for producing alcohol fuels and from eliminating the fuel production credits is expected to be less than $100 million for Fiscal Years 1983-1987.

If the price of oil, and therefore the price of gasoline, rises more than currently anticipated, then the alcohol fuel tax exemption and credit could make substantial quantities of alcohol fuel production profitable. In that event, phasing out the tax incentives will remove an artificial incentive that encourages users to substitute higher cost alcohol fuels for gasoline and will therefore avoid substantial losses in Federal revenue and economic efficiency.

Revenue Estimate

Fiscal Years

1982	1983	1984	1985	1986	1987
($ billions)					
--	0.1	0.3	0.5	0.5	0.5

BUSINESS ENERGY TAX INCENTIVES

Technical Explanation

Summary of the Proposal

Those business energy tax incentives which do not expire on December 31, 1982 will be repealed as of that date. These include certain business energy investment tax credits, tax-exempt financing for hydroelectric and other energy projects, alternative fuel production credits and production incentives for alcohol fuels.

Detailed Description

(1) Energy Tax Credits. Code Section 46(a)(2)(C)(i) provides a table which specifies the energy credit percentage for property which qualifies for the business energy investment tax credit, as well as the dates for which the credit is available. The table will be amended to provide that no credit will be available after December 31, 1982. Thus, for subsequent years, the credit will be repealed for solar, wind or geothermal property described in section 48(l)(2)(A)(ii) or section 48(l)(3)(A)(viii), ocean thermal property described in section 48(l)(3)(A)(ix), small-scale hydrolelectric property described in section 48(l)(2)(A)(vii), qualified intercity buses described in section 48(l)(2)(A)(ix) and biomass property described in section 48(l)(15).

With respect to credits which are scheduled to expire in 1982, section 46(a)(2)(C)(iii) provides that projects with a normal construction period of two years or more will qualify for a credit until 1991, if, by December 31, 1982, all studies are complete and all permits applied for and if, by the end of 1985, binding contracts are entered into for at least 50 percent of the equipment specially designed for that project. This "affirmative commitment" rule also will be repealed, subject to the transition rules described below. The transition rule will extend the availability of these credits to December 31, 1985 for taxpayers who have entered into binding contracts for such projects prior to December 31, 1982.

(2) Production Credits. Section 44D provides a production credit of $3 (in 1979 dollars) for each barrel of oil equivalent, in BTUs, of qualified fuel. Qualified fuels include:

1. oil from shale and tar sands;
2. gas produced from:

a. geopressured brine,
b. Devonian shale,
c. coal seams,
d. a tight formation, or
e. biomass;

3. synthetic fuel produced from coal;
4. certain processed wood fuels; and
5. steam produced from agricultural byproducts.

This credit phases out when the average wellhead price of domestic oil is between $23.50 and $29.50 (in 1979 dollars) with a special but similar rule for certain gases. The phaseout does not apply to the first three years of production of the wood fuels and steam at certain facilities. These credits are available until December 31, 1999.

These credits will be repealed for qualified fuels produced or sold after December 31, 1982.

(3) Energy IDBs. Current law permits tax-exempt industrial development bond (IDB) financing for certain small-scale hydroelectric facilities owned by municipalities (section 103(b)(4)(H)), facilities which produce steam or alcohol from solid waste (section 103(g)), and for certain state programs for energy conservation (section 243 of the Crude Oil Windfall Profit Tax Act of 1980).

These provisions will be repealed for obligations issued after December 31, 1982.

(4) Alcohol Fuels. Sections 4041(k) and 4081(c) exempt a mixture of alcohol and gasoline or diesel fuel which is at least 10 percent alcohol, from the 4 cents per gallon Federal excise taxes on gasoline, diesel or other motor fuels. Section 44E provides a corresponding income tax credit of 40 cents per gallon of alcohol (190 proof or more) and 30 cent per gallon of alcohol (150 to 190 proof) produced for producers of alcohol used as fuel which is not otherwise subject to the excise tax.

The exemption and the credit will be repealed with respect to alcohol fuels produced or sold after December 31, 1982 (or used by the producer in a trade or business after that date).

In addition, the tariff imposed on imported alcohol fuel will be repealed, effective December 31, 1982.

Effective Dates

As a general rule, the business energy tax incentives will be repealed as of December 31, 1982. However, the following transition rules will mitigate the effect of repeal on taxpayers who had relied on existing law.

(1) Any taxpayer who has entered into a binding contract to acquire property eligible for the energy investment tax credits before the date of release will be entitled to current law treatment. The binding contract must be for substantially all of the qualified property in a project to qualify under this rule.

(2) Section 48(m) will be retained. In general, section 48(m) provides that expenditures made on long-term projects (those with construction periods greater than two years) prior to the date a credit is scheduled to expire will qualify for the credit, notwithstanding that the property is placed in service after that date.

(3) Taxpayers who, by December 31, 1982, enter into a binding contract to acquire substantially all of a project described in the "affirmative commitment" rule provisions of section 46(a)(2)(C)(iii) (generally, projects with a normal construction period of two years or more that would have qualified for the credits scheduled to expire in 1982), will be eligible for the energy tax credits until December 31, 1985. The new "affirmative commitment" rule will also be made applicable to two-year (or more) construction property which under current law is eligible for a credit until December 31, 1985.

(4) Facilities which are producing alcohol fuel on the date of release will be eligible for the section 44E alcohol fuel production credit of 40 or 30 cents per gallon, for 1983 through 1985, to the extent of capacity in existence on that date. The credit will be reduced for all qualified producers to 30 cents per gallon (20 cents in the case of 150-190 proof alcohol) January 1, 1986, to 20 cents per gallon (10 cents in the case of 150-190 proof alcohol) January 1, 1987, to 10 cents per gallon (zero in the case of 150-190 proof alcohol) January 1, 1988, and eliminated thereafter. Any taxpayer who has entered into a binding contract prior to February 8, 1982 to acquire an alcohol fuel producing facility will be eligible for the production credit with respect to that facility and the design capacity of the facility will be deemed to be capacity in existence on the date of release.

For both rules (1) and (3), the term "substantially all" is intended to permit an exception where a de minimus portion of a project is not subject to a binding contract on the specified date. For rules (1), (3) and (4), taxpayers self-constructing property must enter into binding contracts for substantially all of the materials and professional and subcontractor services and labor required to complete the project, by the date of release.

TAX-EXEMPT BONDS FOR PRIVATE ACTIVITIES

General Explanation

Current Law

The interest on State and local bonds issued for private activities is generally taxable, with certain exceptions enumerated in the Code. The exceptions include three general categories of tax-exempt revenue bonds for private purposes: 1) industrial development bonds that qualify as exempt small issues; 2) industrial development bonds issued to finance certain exempt activities; and 3) certain other private purpose revenue bonds. A State or local government obligation is an industrial development bond (IDB) if all or a major portion of its proceeds are to be used in the trade or business of a non-exempt person (that is, a person other than a State or local governmental unit or an organization exempt from tax under section 501(c)(3) of the Code) and the obligation is secured by or is to be repaid from trade or business property or receipts.

Exempt Small Issues: Exempt small issue IDB's can be issued in amounts of $1 million or less for the acquisition, construction or improvement of land or depreciable property located in any one city or county. The $1 million limitation can be increased to $10 million at the election of the governmental issuer provided the aggregate amount of exempt small issues outstanding and capital expenditures (other than those financed with exempt small issues) of the business in the particular jurisdiction do not exceed $10 million over a 6-year period. Current law imposes no restrictions on the type or location of business activities that may be financed with exempt small issues.

Industrial Revenue Bonds For Exempt Activities: Current law also provides an income tax exemption for interest on bonds used to finance certain specific "exempt activities." Some of these bonds are used to provide quasi-public facilities such as airports and mass commuting facilities, but others are used for strictly private purposes such as industrial parks and pollution control facilities. No limitation exists on the amount of these obligations or the locations in which they may be used.

Other Private Purpose Revenue Bonds: Specific statutory exemptions currently allow tax-exempt financing for student loans and for organizations that qualify for tax exemption under section 501(c)(3). The principal section 501(c)(3) organizations that use tax-exempt financing are private non-profit hospitals and private non-profit educational institutions. In addition, mortgage revenue bonds to finance certain owner-occupied housing are eligible for tax-exempt financing through 1983.

Reasons for Change

The volume of tax-exempt bonds issued for non-governmental users has grown rapidly during the past five years. The largest growth has occurred in small issue IDB's, which allow access to tax-exempt financing for any type of trade or business. Continued growth in the use of tax-exempt bonds for private purposes is expected unless actions are taken to limit their use. The expansion of tax-exempt bonds for private purposes affects the market for tax-exempt securities as a whole, raising the cost of State and local governments of financing traditional public services.

Many of the private activities using tax-exempt financing would not have received direct Federal or local government assistance. Access to tax-exempt financing is offered in almost all political jurisdictions, either by State or local governments or by authorities acting on their behalf. These authorities are often established for the sole purpose of issuing tax-exempt revenue bonds for private entities and generally serve as mechanisms for avoiding local voter approval requirements.

Providing tax exemption for the interest on certain private purpose obligations may serve legitimate public purposes in some instances. Current law, however, does not require the showing of any genuine public purpose for the project to be financed with tax-exempt obligations. A requirement that private purpose tax-exempt obligations be shown to serve the needs of the local community would improve the uses of the Federal tax benefit and would limit the volume of such obligations, thus reducing their impact on the market for traditional municipal bonds and on the Federal government's revenue loss.

Tax exemption of interest on bonds issued by State or local governments is an important element of the Federal system of government. However, State and local governments have in many cases become merely conduits through which private parties gain access to the tax-exempt bond market. In addition, some local issuing authorities have profited from their ability to pass on the tax exemption by obtaining fees for authorizing bonds for facilities located outside of their own jurisdictions. Private purpose tax-exempt obligations have also been used to obtain substantial arbitrage profits on reserve funds and funds held during temporary construction periods.

The availability of tax-exempt financing for exempt activities and other private purposes causes distortions in the allocation of scarce capital resources. The ability to obtain a lower cost of borrowing for certain activities, for example, businesses requiring pollution control facilities, through the use of tax-exempt financing creates a bias in favor of investment in those activities. In effect, those favored activities, for example, businesses that create pollution, are subsidized at the expense of other activities. Thus, the allocation of capital investments is based upon government decisions rather than their relative economic productivity. Moreover, in combination with the Accelerated Cost Recovery System (ACRS) provided by the Economic Recovery Tax Act, tax-exempt financing can result in a substantial negative tax or subsidy for qualifying activities. Presently, eligible activities are able to add the tax benefits from IDB's to the tax benefits from ACRS. Permitting tax-exempt financing for private investments that also qualify for ACRS would allow companies to borrow at tax-exempt interest rates for investments that provide generally tax-free income. Those companies could then deduct the tax-exempt interest to shelter income from their other assets.

In contrast with other categories of private purpose tax-exempt bonds, exempt small issues may be used in limited dollar amounts for any type of investment in depreciable property or land. Large businesses presently are able to finance numerous facilities nationwide with small-issue IDB's because the dollar limit applies only to a single city or county. Many large firms are using small issue IDB's even though they are able to raise funds readily in capital markets without a government subsidy or guarantee.

Proposal

The proposal limits tax exemption for private purpose obligations currently eligible under section 103 to those issued under the following conditions:

(1) The highest elected official or legislative body, for example, the mayor or city council, of the governmental unit issuing the bonds and in which the facility is located must approve the bonds after a public hearing. Alternatively, the public approval requirement could be met by a voter referendum on the bonds to be issued for the particular facility.

(2) In the case of bonds issued after December 31, 1985, the governmental unit must make a contribution or commitment to the facility financed with tax-exempt bonds. The contribution could take the form of a cash payment, tax credit or abatement, provision of additional services, or payment of the bond issuance expenses with a value on the date the bonds are issued equal to one percent of the face amount of the bonds. Alternatively, the issuing governmental

unit can satisfy the commitment requirement by insuring or guaranteeing the bonds or by designating the bonds as general obligations of the State or local government.

(3) The costs of depreciable assets financed with tax-exempt bonds must be recovered using straight-line depreciation over the extended recovery period used for earnings and profits computation purposes.

(4) Exempt small issue IDB's will be limited to small businesses. A small business is defined as a business that has capital expenditures of less than $20 million over a six-year period. In addition, bonds would not qualify as exempt small issue IDB's if the business will have more than $10 million of IDB's outstanding after issuance of the bonds.

(5) With these restrictions, small issue IDB's could be sold as a part of a composite or umbrella issue of bonds.

(6) Each bond must be in registered form and information concerning the issuance of the obligations must be reported by the State or local government to the Internal Revenue Service.

(7) Restrictions on the investment yield from the use of the proceeds of the obligations are extended to reserve funds and funds held during the temporary construction period. Bond costs may not be taken into account in determining the yield for purposes of the arbitrage limitations.

(8) Except as indicated above with respect to the financial contribution or commitment requirement, the additional restrictions generally apply to private purpose bonds issued after December 31, 1982. However, the restrictions will not apply to single-family mortgage subsidy bonds issued before January 1, 1984, since such bonds after 1983 will be denied tax-exempt status.

Effects of Proposal

The proposal will impose needed limitations on access to the tax-exempt market for private activities. The volume of tax-exempt financing for private purposes has grown enormously during the past five years. New issues of private purpose tax-exempt bonds rose from $8.5 billion in 1976 to over $25 billion in 1981, as shown in the following table. The dollar volume of private purpose bonds increased at an annual rate of 25 percent between 1976 and 1981, while public purpose bond volume rose at a 1 percent annual rate during the same period. Private purpose bonds accounted for 48 percent of the tax-exempt bond market in 1981 compared with only 24 percent in 1976.

Growth in Private Purpose Tax-Exempt Financing
1976 to 1981

	Volume of Tax-Exempt New Issues ($ billions) 1976	1981	Annual Rate of Growth Between 1976 & 1981 (In Percent)
using	$3.0	$6.9	18%
ivate Hospitals	1.9	3.5	13
udent Loans	0.1	1.0	58
llution Control	2.1	3.8	13
all Issue IDB's	1.4	10.5	50
Total	8.5	25.7	25

The reduction in private purpose tax-exempt bonds will help restore the benefit of tax-exempt financing for traditional governmental purposes and will reduce the growing Federal revenue loss attributable to the increasing volume of private purpose tax-exempt obligations. The benefit from tax-exempt financing to borrowers has traditionally been a savings of 30-35 percent of the taxable interest rate. The benefit from tax-exempt financing has fallen to 15-20 percent of the taxable rate on 20-year obligations in 1981, due in large part to the high volume of private purpose tax-exempt bonds. Lowering the volume of private purpose tax-exempt bonds will reduce the interest rates necessary to attract funds to the tax-exempt market.

The proposal requires business users to choose between the benefits of tax-exempt financing and the tax savings from accelerated depreciation allowances. The result is to make the after-tax cost of capital for businesses using ACRS without tax-exempt financing nearly equal to the cost for those using IDB financing. For example, a firm choosing to finance a plant with IDB's after the proposal will have tax benefits equal to 23-29 percent of each dollar invested compared with 26 percent without IDB's. Similarly, for firms financing equipment (5-year ACRS recovery property), the tax savings per dollar invested will be 48-54 percent with IDB's after the proposal compared with 49 percent without IDB's. Without the proposal the combination of tax-exempt financing, ACRS, and the investment tax credit for equipment results in tax savings of 61-67 percent per dollar invested, which offsets not only the future income tax attributable to the equipment, but also the tax on income from other investments.

These restrictions on the use of tax-exempt bonds by private entities are consistent with the goals of the Economic Recovery Tax Act. ACRS provides tax incentives similar to tax-exempt financing, but does so for all capital investments, not just a select group. ACRS is, therefore, an appropriate substitute for tax-exempt financing.

Subject to the additional restrictions on IDB's generally and small issue IDB's in particular, small issue IDB's would be allowed to be sold as a part of a composite or umbrella issue of bonds. When these bonds are limited to small companies, it is appropriate to permit the marketing of packages of these issues to reduce transaction costs and to provide a degree of diversification that may decrease the risk premiums demanded by investors.

Revenue Estimate

Fiscal Years					
1982	1983	1984	1985	1986	1987
($ billions)					
--	-0.2	0.3	1.1	2.1	3.2

TAX-EXEMPT BONDS FOR PRIVATE ACTIVITIES

Technical Explanation

Summary of the Proposal

To insure that tax-exempt obligations issued for private activities serve valid public purposes, the obligations must be approved, after a public hearing by the highest elected official or legislative body of the jurisdiction in which the project is to be located or by a voter referendum.

For bonds issued after December 31, 1985, the governmental unit must make a financial contribution or commitment to the project. The contribution may be a direct grant, tax abatement, or provision of additional services having a value of at least one percent of the face amount of the bonds. The financial commitment may take the form of a general obligation of the governmental unit, or primary guarantee or insurance of the bonds.

Depreciable assets financed with tax-exempt bonds must be written off using the straight-line method over the extended cost recovery period used for computing earnings and profits.

Small issue IDB's will be limited to small businesses that have no more than $20 million of capital expenditures during a six-year period and have no more than $10 million of industrial development bonds outstanding immediately after the issue.

The bonds must be in registered form and information must be reported to the Internal Revenue Service upon the issuance of the bonds.

Restrictions will be placed on the ability of issuers to earn arbitrage profits.

Except as otherwise indicated above, the additional requirements generally would apply to bonds issued after December 31, 1982.

Detailed Description

The proposal imposes four additional requirements on State and local governments issuing tax-exempt bonds for private purposes. Private purpose tax-exempt bonds subject to these requirements include industrial development bonds (section 103(b)(2)); qualified scholarship funding bonds (section 103(a)(2)); and bonds issued for use in a trade or business by section 501(c)(3) organizations (section 103(b)(3)(B)). A fifth requirement prohibiting "double dipping" of tax benefits will apply to all industrial development bonds. A sixth requirement limits small-issue IDB's to small businesses. Mortgage subsidy bonds (section 103A) issued before January 1, 1984 (the "sunset" date for such bonds), are not subject to these requirements.

The first additional requirement is that the bond issue must be approved by the highest elected official or legislative body of the governmental unit by or on whose behalf the bonds are issued and in which the project financed by the bonds is to be located (or in which the eligible sellers of student loan notes are located, in the case of qualified scholarship funding bonds). To satisfy this requirement, bonds issued by or on behalf of a state could be approved by the governor or the State legislature; and bonds issued by or on behalf of a city could be approved by the mayor or the elected city council. As an alternative, the public approval requirement could be met by a voter referendum on the bonds to be issued for the particular project. Any bonds issued by or on behalf of more than one governmental unit must be approved by each governmental unit involved. The public approval requirement would be an additional requirement of the Federal tax law and would not affect the procedures used to approve bonds under applicable local law.

Prior to approval of a bond issue, a public hearing must be held to give members of the public the opportunity to comment upon the proposed bond issuance. Notice of the public hearing must be given prior to the date the public hearing is held. Similarly, notice must be given to the public promptly after the approval of the bonds. Generally, the notice would be sufficient if given in the same manner as required for other legal purposes, for example, by advertising in local newspapers. Both the notice of the public hearing and the notice of approval of the bond issue must describe the facility or activity to be financed by the bond issue and must specifically state the public purpose or purposes that will be served.

The second additional requirement is that the governmental unit issuing the bonds must make a financial contribution or commitment to the project. This requirement will apply to bonds issued after December 31, 1985. A contribution to the facility or project must have a present value equal to one percent of the face amount of the bond. The contribution can take the form of a cash payment, tax credit or abatement, provision of additional services, or payment of bond issuance expenses. The present value of scheduled future contributions to the facility or project must be determined by discounting the future contributions by the yield on the bonds. The contribution must be specifically earmarked for the facility or project and must be approved by the elected official or legislative body that approves the bond issue. General tax reductions or regular services provided to all facilities are not counted for this purpose. However, general tax exemptions provided for exempt organizations under State law could be used to satisfy the contribution requirement with respect to projects for exempt organizations. The governmental unit may not be reimbursed by the user of the facility for any contribution used to satisfy this requirement.

As an alternative means of satisfying the second additional requirement, the issuing governmental unit can make a financial commitment to the project in either of two ways. The financial commitment requirement could be satisfied if the bonds issued are general obligation bonds of the State or local government, or if the State or local government assumes responsibility as the primary insurer or guarantor of the bonds.

The third additional requirement is that the bonds must be in registered form and the issuance of the obligations must be reported by the State or local government to the Internal Revenue Service.

The fourth requirement is related to the unlimited yields issuers presently can earn on private purpose tax-exempt bond proceeds during the temporary construction period and on reserve funds (section 103(c)(4)). The proposal eliminates the exceptions for the temporary construction period and reserve funds for determining whether the bonds are arbitrage bonds. The yield calculation for arbitrage limitation purposes cannot take bond issuance costs into account.

A limitation applying to all industrial development bonds (section 103(b)(2)) is that the costs of depreciable assets financed with tax-exempt IDB's must be recovered using the straight-line method over extended earnings and profit recovery periods (section 312(k), as amended by Section 206 of the Economic Recovery Tax Act of 1981). Assets will not qualify for treatment under the Accelerated Cost Recovery System (ACRS) if they are subject to IDB financing when placed in service by the taxpayer even though the IDB financing was originally obtained by another person or is subsequently paid off. Assets qualifying for the investment tax credit under present law (section 38) will remain eligible for the credit even though they are financed with tax-exempt bonds. The depreciation allowance for any asset financed with tax-exempt IDB's shall be the amount determined under the straight-line method (using a half-year convention in the case of property other than the 15-year real property, and without regard to salvage value), using the following recovery periods:

ACRS Classification	Straight-Line Recovery Period if IDB Financed
3-year property	5 years
5-year property	12 years
10-year property	25 years
15-year real property	35 years
15-year public utility property	35 years

For depreciable assets that are not completely financed with IDB's the denial of ACRS will apply only to the portion financed with tax-exempt debt. Special rules will be provided for determining which assets are deemed to be financed with IDB's.

The final limitation on private purpose tax-exempt bonds restricts the use of small issue IDB's (section 103(b)(6)) to small businesses, defined as those with capital expenditures of less than $20 million during the period from three years before through three years after the issuance of the bonds. In addition, bonds will not qualify as exempt small issue IDB's if the business would have more than $10 million of industrial development bonds outstanding immediately after the sale of the bonds (excluding any previously issued bonds redeemed with the proceeds of the bonds in question). The $1 million and $10 million limitations of existing law will continue to be applicable, except that bonds will not be disqualified solely because they are sold as a part of a composite or umbrella issue of bonds.

Effective Date

Except as otherwise noted with respect to the financial contribution or commitment requirement, these provisions will apply to all private purpose bonds issued after December 31, 1982, including refunding bonds. However, the provisions will not apply to single-family mortgage subsidy bonds issued before January 1, 1984, since such bonds after 1983 will be denied tax-exempt status.

MODIFIED COINSURANCE

General Explanation

Current Law

Modified coinsurance is an arrangement between two insurance companies that has the effect of reducing their combined taxable income. Essentially, this is the result of tax accounting rules that allow Company "A" to pass income to Company "B" without significantly raising B's taxable income. By so doing, Company A can convert investment income, which is taxed at the 46 percent statutory rate, into underwriting income, which is subject to, at most, a tax rate of 23 percent. For many mutual life insurance companies, the additional underwriting income will not be subject to tax because the dividends they pay to policyholders are allowed to offset underwriting income. In recent years, most mutual life insurance companies have paid policyholder dividends in excess of their underwriting income.

Reasons for Change

In form, modified coinsurance agreements involve the transfer of insurance risk between two companies. In substance, virtually no insurance risk is actually transferred. Many policies reinsured under modified coinsurance involve little, if any, present insurance risk. Because there is no meaningful transfer of risk, there is generally no significant non-tax business purpose for most modified coinsurance agreements.

Most modified coinsurance agreements are structured so that actual payment between the companies is a small percentage of the amount of income converted. This small charge represents Company B's fee for entering into the agreement. The nominal amount charged indicates the absence of any significant transfer of risk under modified coinsurance.

The modified coinsurance provision of the Code was never intended to produce large tax benefits for insurance companies. The Federal corporate income paid by the largest mutual life insurance companies fell by 35 percent from 1979 to 1980, and by more than 40 percent from 1980 to 1981. The primary reason for this reduction is modified coinsurance. In several cases, the effect was to nearly eliminate tax liability.

Legislative Proposal

The Code provision that governs the tax treatment of modified coinsurance will be repealed to prevent life insurance companies from converting investment income into underwriting income. In addition, the present tax treatment of other types of coinsurance will be modified to prevent life insurance companies from using these types of arrangements to obtain the same tax benefits presently obtained from using modified coinsurance.

Regulatory Proposal

The current regulations will be amended to limit the extent to which modified coinsurance can be used to convert investment income into underwriting income. The regulations will also be amended to limit the extent to which refunds paid with respect to other forms of coinsurance may be used for this purpose.

Effects of Proposal

A life insurance company's taxable income is the sum of its taxable investment income plus 50 percent of the excess of its underwriting income over the amount of dividends paid to policyholders. In the hypothetical example below, a company with dividends in excess of underwriting income might have taxable income of $100 without modified coinsurance.

Effect of Modified Coinsurance for a Hypothetical Company

Modified	Without Modified Coinsurance	With Coinsurance
(1) Underwriting Income	$ 60	$ 80
(2) Dividends paid to Policyholders	80	80
(3) 50% of excess of (1) over (2)	0	0
(4) Plus Taxable Investment Income	100	80
(5) Equals Taxable Income	100	80

As a result of entering into a modified coinsurance arrangement, this company can increase underwriting income, fully offset by dividends, by $20 and reduce taxable investment income by a like amount. The result is reduced taxable income. The proposal would limit the tax consequences of this type of transaction to the company's out-of-pocket costs, which typically are a small fraction of the income transferred.

The extensive use of modified coinsurance began in 1978 and has been confined to existing policies with substantial accumulated reserves. Life insurance companies have recognized that the tax benefits of modified coinsurance were unintended, and that a legislative change is likely. Thus, companies have not made long-term commitments that depend on the availability of these tax benefits. For these reasons, current insurance rates are unlikely to have been reduced to reflect the reduction in taxes paid.

The proposal will have the greatest effect on the mutual life insurance companies, which tend to be the largest companies in the industry.

Revenue Estimate

Fiscal Years

1982	1983	1984	1985	1986	1987
($ billions)					
0.9	1.9	2.2	2.5	2.7	3.0

MODIFIED COINSURANCE

Technical Explanation

Summary of the Proposal

Regulatory Proposal

The proposed amendments to the regulations will change the treatment of experience refunds paid with respect to both traditional coinsurance and modified coinsurance. The proposed amendments to the regulations will also provide that the parties to a modified coinsurance agreement must allocate income proportionately if the agreement is to be treated under the special rules of section 820.

Legislative Proposal

The Code provision governing the tax treatment of modified coinsurance will be repealed. In addition, the present tax provisions applicable to other types of reinsurance, including the characterization of experience refunds, will be clarified and amended to prevent life insurance companies from using these types of arrangements to obtain unintended tax benefits comparable to those presently obtained from using modified coinsurance.

Detailed Description

Regulatory Proposal

The regulations under sections 809 and 820 will be amended to clarify the treatment of experience refunds to insure that the refund is properly allocated between investment income and premium income. This allocation will be based on the relative contribution of the investment and underwriting activities to the "profits" realized under the agreement. The regulations under section 804 and section 809 will also be amended to provide that the investment income and premium income refunded be included in the reinsured's income but not the reinsurer's income.

In addition, the regulations under section 820 will be amended to provide that modified coinsurance arrangements involving disproportionate allocations of income will not qualify as a modified coinsurance agreement subject to the special rules of section 820.

Legislative Proposal

Section 820 establishes special rules to govern the tax treatment of modified coinsurance contracts if both parties consent to the specified treatment. Under the proposal, section 820 will be repealed.

The proposal also clarifies the treatment of experience refunds. Sections 804 and 809 will be amended to provide that investment income and premium income will be allocated between the parties to the reinsurance agreement in a manner that reflects the economic realities of the arrangement. Section 809(c)(1) also will be amended to delete the reference to "amounts of premiums or other consideration returned to another life insurance company in respect of reinsurance ceded." This clause has been interpreted by taxpayers as allowing all experience refunds paid in connection with reinsurance agreements to be treated as refunds of premium income.

Finally, the proposal provides that reinsurance arrangements involving disproportionate allocations of investment income and premium income will not be respected for tax purposes. Under the proposal, the parties to the agreement will be treated as if a proportionate allocation were specified, and an offsetting experience refund were paid by the reinsurer to the reinsured company. The allocation of the "deemed" experience refund between investment and premium income will be determined in accordance with the general allocations rules to be established under the proposal.

Effective Date

The regulatory proposal will apply to all modified coinsurance agreements entered into after the date the proposed regulations are published. The provisions of the regulatory proposal relating to experience refunds will apply after that date to all existing modified coinsurance and other reinsurance arrangements.

The legislative proposal will apply, in a comparable fashion, after December 31, 1981.

CONSTRUCTION PERIOD INTEREST AND TAXES

General Explanation

Current Law

With certain exceptions, amounts paid or accrued as interest and taxes in connection with the construction of real estate must be capitalized and amortized (deducted ratably) over specified periods. One exception to this rule is that the construction of low-income housing is exempted. Another exception is that corporations (other than those which are personal holding companies or which have elected to be taxed essentially as partnerships) are also exempted from this capitalization rule; corporations that construct real estate may currently deduct the interest and tax costs as they are incurred prior to the time the property is placed in service or offered for sale.

Reasons for Change

It is a well-established financial and tax accounting principal that the costs of acquiring an asset, whether it is held for resale or for use in the production of goods and services for future sale, should be considered a capital cost, not a current cost, of earning income. Only when the asset itself is sold may the capitalized cost be recovered as a deduction from sales proceeds in determining gain; or if the asset is used by the owner to produce goods and services for sale, the capitalized cost may be recovered as deductions over a reasonable period as the asset is used.

The provision of the Code (section 189) that requires unincorporated taxpayers to capitalize construction period interest and taxes (other than those associated with low-income housing) recognizes that these elements of the cost of acquiring such assets are like other construction costs such as labor, materials, fees, and permits, all of which are capitalized and recovered when the buildings are sold or used to produce income. There is no economic policy or tax administration reason why corporations should not be subject to the same rules as individual taxpayers in this regard.

Moreover, in order to achieve the aim of the proposed changes in income tax accounting rules applicable to contractors, section 189 must be expanded to apply also to corporations. This is because a corporation may erect a building on its own account or contract with another to have this done. Under the proposed rules governing income tax accounting for costs incurred by contractors, construction period interest and taxes will have to be cumulated ("capitalized") along with other construction costs by the contractor and become deductible only as he receives payments from the purchaser, for whom these payments are capitalized outlays. Thus, if a corporation contracts with another firm, a corporation, or unincorporated entity, under the proposed contract accounting rules, he will incur a capitalized building cost that includes the full pre-tax amount of interest and property taxes incurred in its construction. But, if the purchaser corporation would not be required to capitalize these same costs if they are incurred on its own account, the corporation will have an incentive to legally arrange its relations with the contractor so as to bring the construction activity into its own accounts and continue to benefit from current deduction of construction period interest and taxes. This would defeat the intent of the contractor accounting proposals.

Proposal

Section 189 of the Internal Revenue Code will be amended to require that corporations capitalize interest and taxes incurred in the construction of nonresidential buildings and recover them ratably over a 10-year period. As provided in section 189, one-tenth of the interest and taxes incurred during a construction year may be deducted in that year; the remaining nine-tenths will be deducted ratably each of the nine years after the building is placed in service. The construction period is defined as the period beginning on the date when construction of the building or improvement commences and ending on the date the property is ready to be placed in service or ready to be held for sale.

Corporations will not be required to capitalize and amortize construction period interest and taxes incurred with respect to residential structures.

Effects of the Proposal

To the extent that capital costs incurred by taxpayers are differentially treated, inefficiencies and inequalities result. Extending application of the section 189 provisions to corporations removes both an unjustifiable differentiation between corporations and unincorporated taxpayers and an unjustifiable distinction between certain costs of constructing buildings and other costs.

One of the results of eliminating the preferential tax treatment of the costs of construction by corporations is that corporations will now confront the equivalent of a higher purchase price for those buildings. In this instance, the equivalent increase in purchase price is in the form of a loss of tax deferral, that is, the substitution of a stream of future deductions for the immediate expensing of construction period interest and taxes. The size of this increase in building acquisition cost is therefore directly dependent on two factors: the length of the construction period and the interest and property tax rates. The longer the duration of the construction period and the higher the interest and property tax rates, the larger the share of total cost of construction represented by these two cost elements and the larger the implicit price increase produced by drastically reducing tax deferral. For interest and property tax rates at current levels and for average nonresidential structure construction periods, the increase in cost due to the proposal is about 2-3 percent. Because a very large fraction of commerical structures has been built by taxpayers already required to capitalize construction period interest and taxes, it is unlikely that this increase in costs confronting corporations will result in observably higher market rentals. Instead, the increase in corporations' non-residential building costs will result in a small reduction in the profitability of corporate investment in buildings.

Revenue Estimate

Fiscal Years

1982	1983	1984	1985	1986	1987
($ billions)					
--	0.5	1.0	1.0	1.0	0.9

CONSTRUCTION PERIOD INTEREST AND TAXES

Technical Explanation

Summary of the Proposal

(1) The proposal generally will apply the provisions of section 189 to corporations now exempted, requiring them to capitalize and amortize over a 10-year period amounts paid or accrued for interest and real property taxes attributable to the construction period of real property.

(2) Corporations will not be required to capitalize and amortize construction period interest and taxes attributable to residential real estate.

Detailed Description

In general, amounts paid or accrued for interest and real property taxes are allowed as a deduction in the year paid or accrued. Exceptions apply in the case of certain prepaid interest. Additionally, under section 266 of the Code, taxpayers may elect to capitalize certain taxes and carrying charges attributable to both real and personal property and to treat the capitalized items as basis.

Under section 189 of the Code (added by the Tax Reform Act of 1976) interest and real property taxes attributable to the construction period of real property must be capitalized and amortized (deducted ratably) over certain periods, generally 10 years. The interest required to be capitalized is all interest paid or accrued on indebtedness incurred, or continued, to acquire, construct, or carry real property. The construction period is defined as the period beginning on the date construction of the building or improvement begins and ending on the date the property is ready to be placed in service or ready to be held for sale.

Section 189 allows the first installment of the capitalized amount to be deducted in the year paid or accrued. Amortization of the remaining balance begins in the year the property is ready to be placed in service or ready to be held for sale.

Presently, section 189 applies only to individuals, subchapter S corporations and personal holding companies. Other corporations are exempted from the provisions. The proposal removes that exemption.

Construction period interest and taxes attributable to residential real estate also are required to be capitalized and amortized under section 189. This rule will not apply to corporations made subject to that section.

All of the other provisions of section 189 will continue to apply. Thus, expenditures for construction period interest and taxes attributable to low-income housing, or to real property that is not (or will not) be held for business or investment purposes, will continue to be currently deductible. Similarly, the election of the taxpayer to capitalize these amounts under section 266 will continue to be available.

Effective Date

The proposal will apply to amounts paid or incurred in taxable years beginning after December 31, 1982.

NEW CORPORATE MINIMUM TAX

General Explanation

Current Law

Under present law, corporations must pay an add-on minimum tax equal to 15 percent of certain items of tax preference in excess of the greater of either $10,000 or 100 percent of the corporation's regular income tax liability. These items of tax preference are: (1) 18/46 of long-term capital gains; (2) percentage depletion in excess of the adjusted basis of the property; (3) depreciation in excess of straightline on low-income rental housing, non-recovery property, or 15-year real property; (4) amortization of pollution control facilities in excess of regular depreciation; (5) amortization of child care facilities in excess of regular depreciation, and (6) reserves for losses on bad debts of financial institutions in excess of the reserves that would have been allowed on the basis of actual experience.

Reasons for Change

Many corporations currently pay little or no Federal corporation income tax, despite reporting large profits to their shareholders. The existing "add-on" minimum tax applies to corporations that have reduced their tax liability through the use of designated tax deductions, but is not focused upon corporations that pay little or no regular income tax. The proposed corporate minimum tax would tax "corporate profits," as measured by regular taxable income plus certain special deductions, and would apply only to those corporations that pay very low regular rates of tax.

Proposal

Effective January 1, 1983, the present add-on corporate minimum tax on certain items of tax preference will be replaced with a new 15 percent alternative minimum tax on "corporate profits" in excess of $50,000, which must be paid only if it exceeds the regular corporate income tax. Corporate profits will be calculated by adding back to a corporation's taxable income (excluding NOL carryovers or carrybacks) the following series of special deductions, which expand upon the items of tax preference subject to the current minimum tax:

(1) excess percentage depletion;
(2) accelerated depreciation on real property;
(3) amortization of certified pollution control facilities;

(4) amortization of child care facilities;
(5) reserves for losses on bad debts of financial institutions;
(6) intangible drilling costs;
(7) mining exploration and development costs;
(8) lessors' leasing benefits;
(9) deductions for debt to buy or carry tax-exempt securities;
(10) deferred DISC income;
(11) certain shipping income;
(12) amortization of motor carrier operating rights;
(13) excess interest on original discount bonds; and
(14) deductions for certain costs incurred with respect to long-term contracts.

No credits other than the foreign tax credit would be allowed to offset the new minimum tax. However, the excess of the minimum tax paid in any year over the regular corporate income tax liability calculated for that year will be carried over as a credit against the regular tax.

Effects of Proposal

Few corporations are affected by the existing minimum tax. In 1981, income tax was owed by 43 percent of corporations. Minimum taxes were paid by 0.3 percent, or 5,500 corporations. Minimum tax collections in 1981 were estimated at $500 million.

	1972	1974	1976
Percentage of Returns Reporting:			
Income Tax	50.7%	49.4%	44.5%
Preference Items	4.2	2.4	1.5
Minimum Tax	0.4	0.3	0.3
		($ Billions)	
Income Tax Collections	22.4	25.3	31.5
Preference Income	7.5	10.2	6.8
Minimum Tax Collections as a Percent of Preference Income . . .	4.2%	3.4%	2.8%

By modifying the minimum tax base to cover corporate income plus an expanded list of preference items, the proposed minimum tax would apply to approximately 90,000 corporations, and would require that profitable corporations currently paying little or no tax would pay at least some tax on their profits.

The new corporate minimum tax will raise corporate tax liabilities by about 5 percent on average. The distribution of current law corporate tax liabilities as well as proposed law liabilities is shown in the following table. The first column in the table indicates the distribution of current law corporate income tax by industry. The new corporate minimum tax, which is based on a better measure of income, increases the tax share of industries that make extensive use of tax preferences, as shown in the second column. Industries that will increase their share of corporate tax liability, on the basis of their current use of tax preferences, are petroleum, banking, and utilities. The mining and real estate industries will pay about their same share of tax, while manufacturing and all other industries (as a group) will pay a lower share of tax under the proposal than under current law.

Distribution of New Corporate Minimum Tax by Industrial Sector

	Percent of Current Corporate Tax Liability		Percent of Proposed Corporate Tax Liability	
Petroleum		5.1%		6.5%
Oil and Gas Extraction	1.6		1.8	
Petroleum Refining	3.5		4.7	
Mining		0.4		0.4
Manufacturing		49.2		47.8
Banking		1.9		2.9
Utilities		2.0		2.3
Real Estate		1.5		1.5
All Others		39.9		38.7
Total		100.0		100.0

The vast majority of corporations, 95 percent, have no change in tax liability. The effect of the minimum tax on particular industries depends both on the use of preferences and the particular economic condition of the industry. As a result it is not possible to estimate with a high degree of reliability an industry distribution of burdens. In addition, estimates do not take into account behavioral changes that reduce income subject to the minimum tax.

Example Applications. The following Example 1 shows the taxation of continued excess preferences under the proposed minimum tax. In the example, taxable income of $20 yields a regular tax of $9.20 at the 46 percent tax rate. Under the minimum tax, $80 of preference income is brought into the tax base each year. This results in a minimum tax of $15 each year rather than the regular tax of $9.20.

Example 1 - Continued Excess Preferences

	Year 1	Year 2
Regular Tax		
Taxable Income	$20	$20
Regular Tax at 46 Percent	9.2	9.2
Minimum Tax		
Taxable Income	20	20
Preference Income	80	80
Total Minimum Tax Base	100	100
Minimum Tax at 15 percent	15	15
Tax Due	(Minimum) 15	(Minimum) 15

Example 2 illustrates the application of the minimum tax credit carryover. In this case the minimum tax advances the payment of $8 of tax but does not alter total tax liability over the two-year period. Taxable income of $100 results in a regular tax liability of $46 before credits which is reduced to $10 by a $36 credit. A minimum tax liability of $18 on $120 of minimum taxable income is paid the first year as it exceeds the regular tax of $10. The $8 excess of minimum tax over regular tax becomes a minimum tax credit which is carried forward to the second year.

In the second year regular tax liability is $30 before the carryforward of the minimum tax credit which reduces the regular tax to $22. As this $22 exceeds the minimum tax, the regular tax becomes the tax liability for the second year. Note that total liability over the two years is not affected by the minimum tax. Instead of a tax liability of $10 and $30 under the regular tax, tax liability becomes $18 and $22 for the same total of $40.

Example 2 - Alternate Years of Minimum Tax and Regular Tax Liability

	Year 1	Year 2
Regular Tax		
Taxable Income	$100	$100
Regular Tax before Credits at 46 Percent	46	46
Investment Credits	36	16
Regular Tax Under Present Law	10	30
Minimum Tax Credit Carryforward	0	8
Regular Tax after Minimum Tax Credit	10	22
Minimum Tax		
Taxable Income	100	100
Preference Income	20	20
Total Minimum Tax Base	120	120
Minimum Tax at 15 Percent	18	18
Minimum Tax Credit (18-10)	8	0
Tax Due	(Minimum) 18	(Regular) 22

Example 3 illustrates the effects of a net operating loss (NOL) carried forward from a previous year. As in the previous example the minimum tax changes the timing but not the two-year total amount of tax. Taxable income is reduced from $100 to zero in the first year by a prior net operating loss of $100. The minimum tax calculated without regard to the NOL is $15. Because it exceeds the regular tax, the minimum tax is the tax liability for year 1.

The regular corporate income tax in the second year is $31 on $100 of taxable income, after an adjustment for the minimum tax credit carryforward. Because the regular tax exceeds the minimum tax, the regular tax is the total tax liability in year 2.

The total tax over the two years remains the same with the minimum tax as under the regular tax. Under current law total tax liabilities are $0 and $46. These amounts become $15 and $31 under the minimum tax for a total tax liability over the two years of $46 on $100 of net total income.

Example 3 - Net Operating Loss

	Year 1	Year 2
Regular Tax		
Taxable Income	$100	$100
NOL Carryover	-100	0
Regular Taxable Income	0	100
Regular Tax at 46 Percent	0	46
Total Regular Tax After Minimum Tax Credit Carryover	0	31
Minimum Tax		
Taxable Income	100	100
Minimum Tax at 15 Percent	15	15
Minimum Tax Credit Carryover	15	0
Tax Due	(Minimum) 15	(Regular) 31

Example 4 demonstrates the operation of the foreign tax credit. In the first year the regular tax is $18.40, at the 46 percent tax rate, on $40.00 of taxable income. The foreign tax credit allowed on $24 of foreign income is $11.04.

The minimum tax on income including preference income is $15 before the foreign tax credit. The foreign tax credit allowed against the minimum tax is 15 percent of expanded foreign income of $40, or $6, leaving a minimum tax liability of $9.00. The minimum tax is paid, because it exceeds the regular tax of $7.36. The $1.64 excess of the minimum tax over the regular tax wil be allowed as a credit against regular tax in later years.

Example 4 - Foreign Tax Credit

		Year 1
Regular Tax		
Taxable Income		$40.00
Regular Tax at 46 Percent		18.40
Foreign Tax Credit (on $24 foreign income after limitation)		11.04
Regular Tax after Foreign Tax Credit		7.36
Minimum Tax		
Taxable Income		$40.00
U.S. Preferences		44.00
Foreign Preferences		16.00
Total Minimum Tax Base		100.00
Minimum Tax at 15 Percent		15.00
Foreign Tax Credit Allowed (15% of $40 of foreign income)		6.00
Minimum Tax After Credit		9.00
Tax Due	(Minimum)	9.00
Minimum Tax Credit Carryover		1.64

Revenue Estimate

Fiscal Years					
1982	1983	1984	1985	1986	1987
($ billions)					
--	2.3	4.8	4.5	3.7	3.8

NEW CORPORATE MINIMUM TAX

Technical Explanation

Summary of the Proposal

The proposal replaces the present 15 percent corporate minimum tax on certain items of tax preference with a new 15 percent minimum tax on "corporate profits," which must be paid only if it exceeds the regular corporate income tax. Corporate profits will be calculated by adding back to a corporation's taxable income a series of special deductions, including but not limited to the items of tax preference subject to the current minimum tax. No credits other than the foreign tax credit would be allowed to offset the new minimum tax. However, the excess of the minimum tax paid in any year over the regular corporate tax liability calculated for that year will be carried over as a credit available against the regular tax.

Detailed Description

Section 56 of the Code will be amended to apply only to persons other than corporations, to Subchapter S corporations and to personal holding companies, and a new section will be added to the Code's minimum tax provisions, imposing a new 15 percent tax on corporate minimum taxable income in excess of $50,000.

The new minimum tax will apply to domestic corporations and to foreign corporations engaged in a trade or business in the United States. The tax base will be a corporation's regular taxable income, increased by the sum of the special deductions described below. The first five items are identical to items currently taxed as corporate tax preferences. The capital gains preference of Code section 57(a)(2)(B) is not listed as an add-in item for purposes of the new minimum tax, because capital gains will be automatically included in the proposed corporate minimum tax base. The increase in any lessees' income from the sale of deductions in a safe harbor leasing transaction will also be automatically included in the minimum tax base, but leases entered into before the date of release will be exempted.

The following special deductions will be added to regular taxable income to calculate minimum taxable income.

(1) Excess percentage depletion. As currently provided in Code section 57(a)(8), percentage depletion in excess of the adjusted basis of the property at year end (figured before deducting depletion for the year) will be included in the corporate minimum tax base.

(2) Accelerated depreciation on real property. As currently provided in Code section 57(a)(2), depreciation on low-income rental housing, certified historic structures, non-recovery property, and 15-year real property in excess of the depreciation allowable under the straight line method over 15 years will be included in the corporate minimum tax base.

(3) Amortization of certified pollution control facilities. As currently provided in Code section 57(a)(4), amortization of certified pollution control facilities in excess of the depreciation normally allowable will be included in the corporate minimum tax base.

(4) Amortization of child care facilities. As currently provided in Code section 57(a)(10), amortization of child care facilities in excess of the depreciation normally allowable will be included in the corporate minimum tax base.

(5) Reserves for losses on bad debts of financial institutions. As currently provided in Code section 57(a)(7), financial institutions will include in their corporate minimum tax base their annual additions to their reserves for losses on bad debts in excess of the reserve deductions that would have been allowable on the basis of actual experience.

(6) Intangible drilling costs. Code section 57(a)(11) will be amended to provide that in the case of corporations (which are currently exempted from application of this section), this addition to the minimum tax base will equal the deduction for intangible drilling and development costs of oil, gas, and geothermal wells (other than dry holes) in excess of the amount allowable had the costs been capitalized and amortized on the straight line basis over 10 years. There would be no offset for the net income from the properties for the year.

(7) Mining exploration and development costs. A new item included in the corporate minimum tax base will be the deductions for mining exploration and development costs in excess of the amortization that would have been allowed on the straight line basis over 10 years.

(8) Lessors' leasing benefits. A new addition to the corporate minimum tax base will be net deductions attributable to section 168(f)(8) leases, in excess of net cash invested by the lessor, amortized on the straight line basis over the lease term. Net deductions to a lessor will be calculated as the current year's ACRS deduction plus interest deductions, minus rental income. Leases entered into before the date of release will be exempted.

(9) Deductions for debt to carry tax-exempt securities. A new addition to the corporate minimum tax base will be interest on indebtedness to purchase or carry tax-exempt securities, to the extent this interest is deducted under current law. The normal rule of section 265(2) disallowing deduction of expenses and interest relating to tax-exempt income does not apply to commercial banks, or to other financial institutions having less than 15 percent of their total assets invested in the tax-exempt obligations. In determining the amount of interest deduction to be added to the minimum tax base, the corporation's total interest deductions will be allocated pro rata across its total investment portfolio.

(10) Deferred DISC income. A new addition to the corporate minimum tax base will be a corporate shareholder's pro rata share of DISC income for the year that is not taxed currently.

(11) Certain shipping income. A new item added back to the corporate minimum tax base will be amounts deposited in construction reserve funds or capital construction funds under the Merchant Marine Act.

(12) Amortization of motor carrier operating rights. Motor carriers will include in their corporate minimum tax base all deductions claimed under Section 266 of the Economic Recovery Act of 1981 for motor carrier operating authorities which diminished in value as a result of the deregulation of motor carriers on July 1, 1980.

(13) Excess OID interest. A new item included in the corporate minimum tax base will be interest deducted on original issue discount bonds in excess of the amount that would be deductible were the interest expense computed on an actuarial basis at the interest rate equal to the yield at which the bond was issued.

(14) Deductions for certain costs incurred with respect to long-term contracts. A new addition to the corporate minimum tax base will be current deductions of certain indirect costs incurred with respect to long-term contracts entered into on or before the date of release, to the extent those deductions exceed the deduction that would have been allowable were these costs capitalized and deducted under the proposed progress payment method of accounting for long-term contracts. The indirect costs listed below are the same costs that would be subject to modification under the Administration's proposal to modify the rules relating to completed contract method of accounting, were the contract entered into after the date of release.

(a) Bidding expenses on contracts awarded to the taxpayer;
(b) Distribution expenses;
(c) Interest;
(d) General and administrative expenses (excluding general marketing, selling and advertising expenses);
(e) Research and experimental expenses directly attributable to particular long-term contracts in existence at the time the expenses are incurred or incurred under an agreement to perform such research and experimentation;
(f) Excess of cost recovery allowances over book depreciation on capital assets;
(g) Pension and profit-sharing contributions representing current service costs;
(h) Officers' compensation; and
(i) Expenses for rework labor, scrap and spoilage.

Net operating loss carryovers and carrybacks as calculated under the regular tax provisions are not allowable as offsets against the corporate minimum tax base.

The corporate minimum tax equals 15 percent of the tax base described above. This tax will be paid only if it exceeds the corporation's regular tax for the year. Payments of estimated tax under section 6154 will be based upon the larger of a corporation's expected regular or minimum tax liabilities.

No credits may be claimed against the corporate minimum tax except credit for foreign taxes paid or accrued during the current year. In determining the allowable credit, the foreign tax credit limitations will be computed separately on the basis of that percentage of the corporation's entire corporate minimum tax base which is derived from sources without the United States. The amount of this recomputed foreign tax credit that then may be claimed against the corporate minimum tax will not be permitted to exceed that portion of the tax attributable to foreign source income. Thus, the credit cannot exceed the gross corporate minimum tax multiplied by a fraction equal to the corporation's minimum tax base derived from foreign sources, divided by the total minimum tax base. The foreign tax credit allowable against the corporate minimum tax will be limited in accordance with section 907; however, all computations under section 907 shall be made with reference to the corporate minimum tax base. In addition, the 15 percent corporate minimum tax rate shall be used instead of the section 11(b) rate.

The amount of any credit or net operating loss carryover or carryback allowable in computing the regular corporate tax will be deemed to be absorbed, even in years in which the corporation pays the corporate minimum tax instead of the regular tax.

However, in order to prevent the loss of tax benefits from credits, NOL carryovers, or any other deductions used in calculating the regular tax, a minimum tax credit will be created. This minimum tax credit will equal the excess of the corporate minimum tax liability in any year over the amount of regular corporate income tax calculated for that year. The minimum tax credit will apply after all other credits available against the regular tax have been exhausted. The minimum tax credit may be carried over for up to fifteen years.

Effective Date

The new corporate minimum tax would be effective for taxable years beginning after December 31, 1982.

WITHHOLDING ON INTEREST AND DIVIDENDS

General Explanation

Current Law

Under current law a withholding tax is imposed at source on wages (at rates from 14 to 37 percent) and on certain gambling winnings (at a 20 percent rate) paid to individual taxpayers.

Current law contains no requirement that tax be withheld on interest and dividend income paid to domestic taxpayers. Instead, payors of interest and dividends are required generally to file information returns reporting the amount of interest and dividend payments that aggregate $10 or more per person in a calendar year. There are no information return reporting requirements relating to coupon interest payments or original issue discount on corporate bearer obligations or interest on United States government obligations.

Reasons for Change

Individuals who fail to report their interest and dividends pay less than their a fair share of the total tax burden. Recovering known lost tax revenues by withholding -- when the reporting system is already largely in place -- is both an efficient and a sensible step to take.

While individuals are estimated to underreport wage income by only 2 to 3 percent, the comparable figure for interest and dividend income is 9 to 16 percent. Even with the additional reporting requirements enacted in the Revenue Act of 1962, a number of taxpayers still fail to report and pay tax on around $20 billion of taxable dividends and interest.

As interest and dividends have increased as a share of individual incomes, the compliance problem of underreporting has also increased: In 1962, interest and dividends represented approximately 5.3 percent of adjusted gross income; by 1981, interest and dividends represented fully 8.4 percent of reported adjusted gross income -- an increase from $40 billion to $150 billion. At the same time, the portion of individuals' income represented by wages has declined by at least an equivalent amount. As a result of this change in the composition of the Nation's income, taxpayer compliance overall has declined because a smaller portion of overall income is now subject to withholding.

The expanded information reporting requirements that were adopted in 1962 are simply inadequate to insure full compliance in reporting interest and dividend income. First, much of the nonreporting is apparently due to inadvertence, forgetfulness and failure to keep records, particularly by taxpayers who receive relatively small amounts of dividend and interest income. Any attempt to close the entire gap of unreported income by means of information reporting and audit procedures would require millions of telephone calls, letters and visits, many involving small amounts of tax, which would almost inevitably be regarded as harassment of "little people."

Second, the cost of following up the millions of apparent discrepancies in the reporting of interest and dividend income would be demonstrably uneconomical. Such an enforcement effort could not be reconciled with any sound concept of tax administration.

Third, the failure of payors to comply fully with information reporting requirements limits the use of information documents in verifying the reporting of interest and dividend income. More than 11 percent of information returns required to be filed by payors (Form 1099's) have inaccurate or missing Social Security numbers (taxpayer identifying numbers), making accurate matching of documents in such cases extraordinarily expensive. By comparison, the rate of error on information returns for wages (Form W-2), where the taxpayer is entitled to a credit for the taxes paid, is estimated to be about 3 percent.

Fourth, even extensive pursuit of taxpayers would not achieve full collection of unpaid taxes. There would be many unfruitful investigations where taxpayers cannot be reached by telephone or traced if they have moved. Thus, even after taxes have been assessed, it would sometimes be impossible to collect them.

It is also important that our income tax system treat all forms of income similarly. Recipients of interest and dividends should pay their taxes with no less certainty than persons who receive wages or other types of income presently subject to withholding, and those taxes should be paid just as promptly.

The obvious failure of some taxpayers to report interest and dividend income diminishes public respect for the tax system, and jeopardizes our system of voluntary compliance. Moreover, experience has shown that withholding is by far the most effective means of improving compliance in the reporting of income.

<u>Proposal</u>

A flat rate tax of 5 percent will be withheld from interest and dividend payments made to individuals. This withholding will take place in generally the same manner that tax is presently withheld on wages. Recipients of interest and dividend payments subject to withholding will claim a credit on their tax returns for the withheld tax. Withholding agents will provide recipients with a statement that will show both the amount of interest and dividends paid during the year and the amount of tax withheld. A copy of this statement will also be filed with the IRS by the withholding agent. In addition, taxpayers, even if exempt from withholding, will include a copy of each statement with their tax returns if they are otherwise required to file. This procedure is similar to that required for wage withholding statements. The amount of tax withheld on interest and dividends will generally be provided on the same forms that are currently used for information reporting purposes, modified to show the amount of tax withheld.

The proposal broadly includes all interest and dividend payments made to individuals on all securities of a type generally offered to the public. This includes interest not now subject to information reporting. Over 80 percent of all interest and dividend payments (including interest payments on certain government obligations) now made to individuals that will be subject to withholding are covered by information reporting.

If there were gaps in the coverage of withholding, those obligations subject to withholding might suffer a competitive disadvantage and funds might be diverted to other instruments. In particular, if bearer obligations were not covered by withholding there might be a proliferation of this type of instrument, which presents the greatest potential for evasion. Therefore, in order to ensure that the absence of withholding does not artificially favor one form of investment over another, the withholding system will be as comprehensive as possible.

Certain individuals will be exempt from the withholding requirements. Other provisions will reduce the time between withholding and the availability of a refund to which a taxpayer may be entitled. First, individuals who did not owe tax in the preceding year and who reasonably expect to owe no tax for the current year will be permitted to exempt themselves from withholding by filing an exemption certificate with the withholding agent. Second, individuals who are age 65 or over and who had a tax liability of less than $500 ($1,000 for a married couple filing jointly) both in the prior year and the current year may also file exemption certificates. Elderly, single individuals with adjusted gross income of less than $8,060 in 1983 ($14,907 for a married couple filing jointly) will have sufficiently small tax liabilities to file exemption certificates. Over 70 percent of elderly persons will not be subject to withholding as a result of these exemptions.

To minimize the administrative burden on payors of processing exemption certificates, the certificates will be permanent until revoked by the taxpayer.

Depository institutions will be permitted to withhold once at the end of the year on passbook-type accounts and interest-bearing checking accounts so that a taxpayer who is entitled to do so may apply for a refund shortly after the time that tax has been withheld.

Individuals will be able to make certain adjustments and thereby avoid overwithholding. Individuals who currently make estimated tax payments can reduce their estimated tax payments by the amount of taxes withheld from their interest and dividend income. In determining the amount of taxes withheld from their wages, wage earners will be permitted, under the provisions of the Economic Recovery Tax Act of 1981, to take into account the amount of taxes withheld from their interest and dividend income. These two adjustments will allow virtually all taxpayers to avoid overwithholding. Individuals will not be allowed partial exemptions for the $100/$200 dividend exclusion or for the 15 percent net interest exclusion (available after 1984). However, no withholding will be required on interest paid on All-Savers' Certificates, dividends reinvested in public utility stock as part of a qualified Dividend Reinvestment Plan, or tax-exempt interest paid on State and local bonds.

In addition to payments to individuals, the proposed withholding system will apply to payments to most partnerships and most trusts and estates. However, it will not apply to payments to corporations (including corporate nominees and corporate trustees) and to noncorporate securities dealers.

Effects of the Proposal

Because of the opportunity to file exemption certificates and to adjust both estimated taxes and wage withholding, virtually every taxpayer will be able to avoid overwithholding. At 1981 levels of income, over 70 percent of the population aged 65 or over will be eligible for exemption certificates.

The following two examples illustrate how the new withholding system will affect the elderly. In example 1, a couple with $15,000 of income (including $5,000 of nontaxable Social Security benefits) is fully exempt from withholding on $8,000 interest and dividend income. In example 2, a couple receiving income of $22,000 (including $7,000 of nontaxable Social Security benefits) has $600 withheld from interest and dividend income of $12,000. This latter couple will simply reduce each quarterly estimated tax payment by $150 to fully offset the withheld tax. Both examples demonstrate that overwithholding does not occur.

Examples of Withholding for Elderly Couples in 1983

		Example 1	Example 2
Social Security Income		$ 5,000	$7,000
Pension Income		2,000	3,000
Interest and Dividend Income		8,000	12,000
Total Income		15,000	22,000
Adjusted Gross Income (excludes social security)		10,000	15,000
Taxes Due (non-itemizers)		296	1,014
Tax Withheld on Interest and Dividends	(Exempt)	0	600

For those who are allowed to make adjustments, but who fail to do so, the proposal will make an almost imperceptible change in the yield on savings. Taxes that are withheld become a tax credit taxpayers may claim against their final tax liability. Even when withholding results in a more rapid payment of taxes, in the worst case possible the loss of interest on withheld tax would only be around 1/50th of 1 percent of asset value or a reduction in the effective rate of return from, say, 9.00 percent to 8.98 percent. Withholding could be a savings disincentive only to those who do not pay all the taxes which they owe on interest and dividends. However, it would be ridiculous to argue that tax evasion should be used as an incentive to save.

The implementation of withholding, along with the attachment of Form 1099's to the income tax returns, will result in materially greater levels of compliance. Taxpayers and payors of interest and dividends will have a positive incentive to report and record accurately taxpayer identification numbers. Taxpayers who currently fail to claim all their interest and dividend income on returns will be much less likely to make affirmative statements of exemption on exemption certificates.

Revenue Estimate

	Fiscal Years					
	1982	1983	1984	1985	1986	1987
	($ billions)					
Increase in compliance .	--	0.5	1.1	1.2	1.4	1.5
Change in timing	--	1.4	0.2	0.2	0.2	0.4
Total	--	2.0	1.3	1.4	1.6	1.9

WITHHOLDING ON INTEREST AND DIVIDENDS

Technical Explanation

Summary of the Proposal

A flat rate tax of 5 percent will be withheld from interest and dividend payments made to individuals in generally the same manner that tax is presently withheld on wages. Corporations and nontaxable individuals filing exemption certificates would be exempt from withholding. Taxpayers age 65 or older with tax liability of $500 ($1,000 on a joint return) or less would also be exempt from withholding.

Detailed Description

(1) Scope and Operation of Proposal

The proposal broadly covers all payments of taxable dividends and interest that are presently subject to information reporting, as well as payments on other obligations of a type generally offered to the public. Interest paid by individuals would not be subject to withholding. The proposal would extend withholding to included payments without a threshold dollar amount.

Recipients of interest and dividend payments subject to withholding will claim a credit on their tax returns for the withheld tax just as they do for taxes withheld on wages. Withholding agents will provide recipients with a statement showing both the amount of interest and dividends paid during the year, and the amount of tax withheld. Payors will send a copy of the statement to the IRS. Payees will be required to attach a copy to their income tax returns. The statements will be provided on the same forms that are currently used for information reporting purposes, modified to show the amount of tax withheld.

Full exemptions from withholding are provided in two situations. First, individuals who did not owe tax in the preceding year and who reasonably expect to owe no tax in the current year will be permitted to exempt themselves from withholding by filing an exemption certificate with the withholding agent. Second, individuals who are age 65 or over with tax liability of less than $500 ($1,000 for a married couple filing jointly) both in the prior year and current year will be eligible to file exemption certificates. Elderly, single individuals with adjusted gross income of less than $8,060 in 1983 ($14,907 for a married couple filing jointly) will always have a small enough tax liability to file exemption certificates. Exempt levels of income will be even higher for those receiving nontaxable income such as

Social Security benefits and for those itemizing their deductions. Over 70 percent of the elderly will be exempt from withholding. To minimize the administrative burden on payors of processing exemption certificates, the certificates will be effective until revoked by the taxpayer.

Individuals will be able to make adjustments to avoid overwithholding on interest and dividends. Those who make estimated tax payments will be able to reduce their estimated tax payments by the amount of taxes withheld from their interest and dividend income. Wage earners will, under the provisions of the Economic Recovery Tax Act of 1981, be permitted to take into account the amount of taxes withheld from their interest and dividend income. With these two adjustments virtually all taxpayers will be able to avoid overwithholding.

Although individuals will not be allowed partial exemptions from withholding for the $100/$200 dividend exclusion or the 15 percent net interest exclusion (effective after 1984), no withholding will be required on interest paid on All-Saver's Certificates, dividends reinvested in public utilities' stock pursuant to a qualified Dividend Reinvestment Plan, or interest paid on tax-exempt state and local bonds.

(2) <u>Coverage of Corporations and Noncorporate Entities</u>

Payments to corporations -- including corporate nominees and corporate trustees -- will be exempt from withholding. A payor will be entitled to rely on an unambiguous expression of corporate limited liability, such as the use of "incorporated" or "inc." in the name of the payee, rather than an exemption certificate. The exemption for corporations will include regulated investment companies, collective investment funds managed by banks, money market funds and the like. Noncorporate nominees are also exempt, but will generally have to file exemption certificates. Nominees will, however, be required to withhold upon payment of dividends or interest to their non-exempt customers, shareholders or certificateholders. Securities dealers who are required to register as broker-dealers under State or Federal law will be eligible to file exemption certificates. Their exemption may be established either by reasonable reliance on some published list or directory, or by an exemption certificate.

The proposal will not affect reporting and withholding requirements that currently exist for interest and dividend payments to foreign individuals and corporations. Present law will continue to apply to such payments.

Payments to tax-exempt organizations such as state and local governments and entities exempt from tax under section

501(a) will be exempt from withholding. The withholding agent may rely on an unambiguous indication that the entity is exempt by reason of its name -- Blackacre University, State of X -- or may require an exemption certificate.

Partnerships, other than partnerships that are mere nominees or are registered under the Investment Company Act of 1940, will not be exempt from withholding. The credit for withheld taxes associated with payments to a partnership will be allocated among the partners in proportion to the gross amount of interest and dividend income giving rise to the credit allocable to them. Similarly, trusts (other than trusts having corporate trustees) and estates generally will not be exempt from withholding. (Where one or more of the trustees of a trust is a corporation, the corporate trustee, itself, must withhold on interest and dividends received by the trust (whether or not distributed) at the time such amounts are credited to the trust account.) The credit for withheld taxes will be allocated among beneficiaries and the trust on the basis of the amounts of interest and dividend income giving rise to the credit allocable to each. Withholding from distributions by a partnership (other than a partnership registered under the Investment Company Act of 1940), trust or estate will not be required.

(3) Responsibilities of Withholding Agents

The withholding agent will generally be the person making payments of interest and dividends to individual taxpayers. Thus, a depository institution will withhold from interest credited to depository accounts. In the case of stocks or securities, withholding will be carried out by the paying agent of the issuer. In the case of coupon redemptions, the responsibility for withholding will be placed on either the paying agent of the issuer or the institution that first accepts the interest coupon. The withholding agent will pay the net amount of the coupon to the holder and will transmit a form to the IRS and the holder identifying the payee and the withheld amount. The U.S. Treasury will be the withholding agent for bills purchased directly from the Treasury or a Federal Reserve Bank and recorded in the Treasury's book-entry system. The Treasury also will act as withholding agent for registered Treasury notes and bonds. For those United States obligations held in book-entry form in the secondary market, the bank or other entity maintaining the account will be the withholding agent.

When stocks or securities are registered in the name of a brokerage firm or other nominee that is exempt from withholding, the nominee will be required to withhold when the interest or dividend payments are credited to individual customers' accounts. This requirement follows the current rules for information reporting by nominees.

(4) Application of Proposal to Specific Instruments

(a) Deposit accounts and interest bearing checking accounts

For accounts with depository institutions, withholding will ordinarily occur when the interest is credited to the account, but not less often than annually. If premature withdrawal of amounts from a term account results in a penalty charge, only the net interest payment to the depositor (interest earned less penalty) will be subject to withholding. In the the case of six-month "money market" certificates, if the interest is credited only at maturity, withholding will occur at that time even if the certificate overlaps two taxable years. In addition, institutions will have the option to withhold from passbook accounts annually, regardless of the frequency with which interest is posted. Interest-bearing checking accounts will generally be subject to these rules. (Deferral of withholding for such accounts will be accelerated, however, if the account is closed, and in no event will the account balance be permitted to fall below an amount equal to the deferred withholding.)

The Secretary will have the authority to allow payments of withholding to be made from alternate sources in the same institution. In the case of instruments with a term longer than one year entered into prior to the effective date of the proposal, and with respect to which interest is payable only at maturity, no withholding will be required on an annual basis except for interest earned in the year of maturity of the instrument.

(b) Corporate dividends

Withholding from dividends will be required at the time of distribution. For this purpose, a dividend will include any distribution made by a corporation to its shareholders that is a distribution out of current or accumulated earnings and profits under section 316. Also subject to withholding will be any payment made by a stockbroker to any person as a substitute for a dividend, such as a payment in lieu of a dividend made to a person whose stock is borrowed in connection with a short sale. Distributions of stock and rights to acquire stock made by a corporation to its shareholders that are excluded from income under section 305 will not be subject to withholding. However, withholding will be required from dividends which a stockholder elects to automatically reinvest in stock of the corporation (other than dividends of public utility stock issued as part of a qualified Dividend Reinvestment Plan).

Any portion of a distribution made by a corporation to its shareholders that is not made from current or accumulated earnings and profits and is treated as non-taxable return of capital or capital gain under sections 301(c)(2) or (3) will not be subject to withholding. If a payor is unable to determine the portion of a distribution not subject to withholding under this rule, withholding will be applied against the entire distribution. For corporations that regularly make distributions that are not out of current or accumulated earnings and profits, the Secretary will have authority to prescribe regulations permitting such corporations to make a reasonable estimate of that part of the distribution not out of current or accumulated earnings and profits, and to exempt that estimated portion from withholding.

(c) Amounts Paid by Mutual Funds, Unit Investment Trusts and Similar Entities

All corporations, including investment companies organized as corporations, such as most mutual funds, will be exempt. Similar entities that are not organized in corporate form but that are taxed as regulated investment companies also will be exempt. Also exempt is any other entity excluded from the definition of a "regulated investment company" under section 851 of the Code, but registered at all times during the tax year under the Investment Company Act of 1940 as well as a "common trust fund" as defined in section 584(a) of the Code.

These entities will be required to withhold on distributions (including constructive distributions) to their non-exempt shareholders or certificateholders. Withholding will generally take place at the time of distribution, or reinvestment, if the distributions are subject to automatic reinvestment.

Withholding will not apply, however, to a distribution (including a constructive distribution) to the extent that the distribution constitutes a capital gain dividend under section 852(b)(3)(C). In addition, a regulated investment company that is eligible to distribute "exempt interest" dividends under section 852(b)(5) and that reasonably expects that such dividends will constitute at least 95 percent of its aggregate dividends (excluding capital gain dividends) in a taxable year, will not be required to withhold with respect to any dividends in that taxable year. Under no circumstances will such an entity be required to withhold on any dividend, or portion thereof, which constitutes an "exempt interest" dividend.

(d) Short-term Corporate Obligations

In the case of interest-bearing corporate obligations with an original maturity of one year or less, withholding will be required on the interest payment date. Withholding will encompass both the stated interest and any amount of discount reportable as interest.

For a short-term corporate discount obligations (for example, commercial paper, bankers' acceptances and repurchase agreements), withholding will be required at maturity. The holder of the obligation will be required to present the paying agent with a confirmation slip or other similar document indicating the holder's purchase price for the obligation. Paying agents will be able to rely on transaction confirmation documents of the type generally given to a buyer by the issuer, a broker or other third party. In the absence of such documentation, the paying agent will compute the amount of discount to be withheld upon as the difference between the average issue price of the obligation and the face amount of the obligation payable at maturity.

(e) Long-term Corporate Obligations

In the case of interest-bearing corporate obligations issued in registered form (defined in Treas. Reg. section 1.6049-2), withholding will take place on the interest payment date.

Withholding of 5 percent of the amount of ratably includable original issue discount on each interest payment (but not less than once annually) will be required. These rules requiring withholding with respect to both stated interest and the ratably includable portion of original issue discount will apply to bearer issues.

(f) United States Government Obligations

(i) Treasury Bills

Withholding on Treasury bills will be required at maturity. If the instrument had been held by the owner in an account with the withholding agent since its original issuance or if the bill is acquired on the secondary market for the owner by such agent, the discount will be computed as the difference between the par value of the bill and the purchase price. If the bill is transferred to a new account after issue, the owner of the bill at maturity must provide the withholding agent with satisfactory evidence of the purchase price and the time of purchase. In the absence of such documentation, the withholding must assume that the bill was purchased at the time bills with similar CUSIP numbers were first issued and at the prevailing noncompetitive price.

(ii) Savings Bonds

Withholding will be required from interest on a Series E, or EE Bond, or a savings note, at the time the security is presented to a financial institution for redemption. Taxpayers who have elected to include income ratably over the term of the instrument will be authorized to claim exemption from withholding on previously accrued income by delivering an appropriate certificate to the financial institution at the time of redemption. The Bureau of the Public Debt will then reimburse the financial institution for the actual amount paid to its customer. Information as to the amount of interest paid and the amount of tax withheld will be provided to the person redeeming the security and will be transmitted to the IRS together with other identifying information furnished by such person. Interest paid semiannually on Series H or HH Savings Bonds will be withheld by the Bureau of Public Debt on interest payment dates.

(iii) Treasury Notes and Bonds

Withholding on Treasury notes and bonds will occur on interest payment dates. For notes and bonds held in book-entry form in accounts maintained by financial institutions, security dealers, etc., such entities will act as the withholding agent. In the case of bearer securities, the entity to which the coupon is presented will be the withholding agent, regardless of whether the coupon is taken subject to collection.

(g) Dividends of Subchapter S Corporations

A Subchapter S corporation will be required to withhold at the time dividends are paid to its shareholders. No withholding will be required on constructive dividend distributions at year-end. However, withholding will be required from distributions made within 2 1/2 months of the end of a tax year which are treated as having been made out of the prior year's undistributed taxable income. The credit will be treated as applicable to dividends paid during the prior year.

(h) Interest Payments from Mortgage Pass-through and Mortgage Participation Certificates

In general, withholding will apply to interest paid with respect to all securities offered to the public, regardless of the assets securing the securities. In the case of mortgage pass-through and mortgage participation certificates, for example, investors in such certificates regard the interest that they receive as the return on the investment made in the purchase of the certificate, regardless of their constructive ownership of the underlying mortgage assets for tax purposes. These certificates, therefore, are treated no differently for withholding purposes than other securities offered to the general public.

Effective Date

Withholding will apply to interest and dividend payments made after December 31, 1982.

ACCELERATED CORPORATE INCOME TAX PAYMENTS

General Explanation

Current Law

Under current law, corporations are generally required to make installment payments of estimated tax on the 15th day of the 4th, 6th, 9th, and 12th months of their tax year. Because estimated taxes are only estimates, a substantial deviation from tax liability is permitted before any penalties are applied for underestimating taxes. Generally, there is no penalty for underestimation so long as estimated tax payments are made ratably each quarter and are equal to at least 80 percent of the tax liability as shown on the tax return when it is filed after the close of the tax year. A penalty is applied to the difference between 80 percent of such tax liability and the total estimated tax payments. The penalty is computed at the same rate as the rate of interest charged and paid by the Internal Revenue Service, but unlike interest the penalty is not a deductible expense.

There are three additional circumstances under which no penalty for underestimation of taxes is imposed. No penalty is charged for any payment of less than 80 percent of the liability as shown on the tax return if the payments were made on or before the due date of the installment and the total payments up to the particular due date in question equal or exceed the amount which would have been due if the estimated tax were based on any of the following:

1. The corporation's prior year tax liability;
2. The corporation's tax liability on prior year's income computed using tax rates for the current year; or
3. Eighty percent of the taxes which would have been due if the income which the corporation had already received during the current year had been placed on an annualized basis.

The extent to which large corporations can use exceptions 1 and 2 was limited in 1980 and again in 1981. Regardless of these exceptions, estimated tax payments of large corporations (those with over $1 million of taxable income in any of the three preceding tax years) must be at least 60 percent of their current year liabilities in 1981, 65 percent in 1982, 75 percent in 1983, and 80 percent in 1984 and thereafter.

The due date for a corporation's income tax return is two and one-half months after the close of its tax year. Half of any tax liability which has not been satisfied by estimated tax payments is due on the date on which the corporation's income tax return is due whether or not the return itself is actually filed on that date. The remaining half of the unpaid liability is due three months later.

Reasons for Change

To the extent feasible, taxes should be paid on a current basis. Given the ability of corporations to estimate their income on a monthly basis, there is no longer any reason to permit corporations to underpay their taxes by up to 20 percent without any penalty. A 10 percent deviation is sufficient to reflect the uncertainties of intra-year estimates.

Proposal

The proposal has three parts:

(1) Increase required estimated tax payments from 80 percent to 90 percent of current year liability.

(2) Require all remaining liability to be paid on the 15th day of the third month following the close of the tax year rather than half on the 15th day of third month and half on the 15th day of sixth month.

(3) For large corporations (those with over $1 million of taxable income in any of the three preceding years) which base their estimated tax payments on the prior year income or liability, increase the minimum required payment to 85 percent of current year liability in 1985 and to 90 percent in 1986 and thereafter.

The first two proposals will be effective for tax years beginning after December 31, 1982. The third proposal will be effective for tax years beginning after December 31, 1984.

Effects of the Proposal

The proposed speedup of corporate tax payments represents a reduction in the potential interest corporations can earn on their accrued, but unpaid, tax liability. When the proposal is fully effective, this additional cost to corporations will be about $460 million per year at projected 1986 levels of tax collections, an increase in corporate income taxes of about 0.6 percent.

Revenue Estimates

		Fiscal Years			
1982	1983	1984	1985	1986	1987
		($ billions)			
--	1.4	1.7	0.9	0.2	-0.2

ACCELERATED CORPORATE INCOME TAX PAYMENTS

Technical Explanation

Summary of the Proposal

For tax years beginning after 1982, the required estimated tax payment for a corporation will be increased from 80 percent to 90 percent of its current year liability, and all of its remaining liability will be required to be paid in one payment on the 15th day of the third month following the close of its tax year. In addition, large corporations making estimated tax payments based on their prior year incomes or liabilities will be required to pay at least 85 percent of their current year liabilities in 1985 and 90 percent thereafter.

Detailed Description

Under the proposal, for tax years beginning after December 31, 1982, required estimated tax payments will be increased from 80 percent to 90 percent of corporations' current year liabilities. All remaining liability will be required to be paid on the 15th day of the third month following the close of the tax year, which is the due date for corporations' income tax returns. Even if a corporation receives an extension of time to file its tax return, it will be required to pay any remaining liability by the original due date of its tax return. This is an acceleration from current law, which requires half of all remaining liability to be paid on the 15th of the third month, and the other half on the 15th of the sixth month.

In addition, for large corporations (those with over $1 million of taxable income in any of the three preceding years) the proposal will increase minimum required payments if those payments are based on prior year incomes or liabilities to 85 percent of current year liabilities in 1985 and 90 percent in 1986 and thereafter. Generally, corporations may meet their estimated tax requirements by paying 100 percent of their liabilities for the preceding year (or 100 percent of their liabilities based on prior year incomes but current year tax rates) or 80 percent of their liabilities based on annualization of current year-to-date incomes. Under current law, large corporations may not use the prior year exceptions to make tax payments of less than 65 percent of their current year liabilities for 1982, 75 percent for 1983, and 80 percent for 1984 and thereafter.

Since many corporations currently do not file their returns until after the due date for the second installment of their final tax payments, present administrative procedures will be adequate to handle impositions of interest and penalties on any tax payments which are not made by the 15th day of the third month after the close of a corporation's tax year.

No changes in procedure by either corporations or the government will be required to handle the increased proportion of current year tax liabilities which must be paid by large corporations which base their estimated tax payments on prior year incomes or liabilities.

Effective Date

The increase in required estimated tax payments to 90 percent of current liability and the accelerated date for payment of all remaining liability will be effective for tax years beginning after December 31, 1982. The increase in estimated tax payments based on prior year income or liability for large corporations will be effective for tax years beginning after December 31, 1984.

IRS ENFORCEMENT STAFF INCREASES

General Explanation

Reasons for Change

Although the vast majority of taxpayers voluntarily pay their correct tax on time, delinquent taxpayers currently owe the Treasury more than $20 billion in uncollected taxes. An additional $70 billion in revenues are lost each year as a result of unreported income and improper deductions. A strengthening of Internal Revenue Service enforcement activities will generate increased government revenue and will improve the fairness of the tax system for all taxpayers. Public confidence in the equity of our tax laws is preserved only if the few who fail to pay their fair share are held accountable.

Proposal

The Internal Revenue Service will add more than 5,000 positions to enforcement activities. For fiscal year 1983 these positions are allocated as follows:

Function	Number of Positions
Collection of delinquent accounts........	3,000
Identification of nonfilers..............	1,000
Examination of deficient returns.........	1,000
Appeals..................................	225
Total..................................	5,225

Effects of Proposal

This proposed staff increase will help instill confidence in the equity of the tax system by raising $2.1 billion in taxes which otherwise would not be collected in fiscal year 1983. Since the additional cost to the government will be only $0.2 billion, the revenue increase net of costs will be $1.9 billion. Through fiscal year 1987, additional receipts will total $8.8 billion, or $8.2 billion net of the $0.6 billion increased staffing costs.

Revenue Estimate

Fiscal Years

1982	1983	1984	1985	1986	1987
($ billions)					
0.2	2.1	2.4	2.4	1.3	0.6

The Effect on Fiscal Year Receipts of Tax Revisions
and Improved Collection and Enforcement Proposals

($ billions)

	Fiscal Years					
	1982	1983	1984	1985	1986	1987
Completed contract method of accounting (January 1, 1983)	*	1.9	4.4	4.6	4.1	4.0
Business energy tax incentives (January 1, 1983)	—	0.1	0.3	0.5	0.5	0.5
Tax-exempt bonds for private activities (January 1, 1983)	—	-0.2	0.3	1.1	2.1	3.2
Modified coinsurance (January 1, 1982) ..	0.9	1.9	2.2	2.5	2.7	3.0
Construction period interest and taxes (January 1, 1983)	—	0.5	1.0	1.0	1.0	0.9
Corporate minimum tax (January 1, 1983) .	—	2.3	4.8	4.5	3.7	3.8
Withholding on interest and dividends (January 1, 1983)	—	2.0	1.3	1.4	1.6	1.9
Accelerated corporate income tax payments (January 1, 1983)	—	1.4	1.7	0.9	0.2	-0.2
Internal Revenue Service enforcement staff increases	0.2	2.1	2.4	2.4	1.3	0.6
Total	1.1	12.1	18.4	18.9	17.2	17.8

Office of the Secretary of the Treasury
Office of Tax Analysis

February 26, 1982

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

*$50 million or less.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

January 27, 1982

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE

TREASURY FEBRUARY QUARTERLY FINANCING

The Treasury will raise about $5,700 million of new cash and refund $4,320 million of securities maturing February 15, 1982, by issuing $5,000 million of 3-year notes, $2,500 million of 10-year notes, and $2,500 million of 29-3/4-year bonds. The 29-3/4-year bonds will be an addition to the 14% bonds of 2006-2011, originally issued November 16, 1981. The public currently holds $1,987 million of the outstanding 14% bonds.

The $4,320 million of maturing securities are those held by the public, including $178 million held, as of today, by Federal Reserve Banks as agents for foreign and international monetary authorities. In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $1,079 million of the maturing securities that may be refunded by issuing additional amounts of new securities. Additional amounts of the new securities may also be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing securities held by them.

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

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Attachment

R-586

HIGHLIGHTS OF TREASURY
OFFERINGS TO THE PUBLIC
FEBRUARY 1982 FINANCING
TO BE ISSUED FEBRUARY 16, 1982

January 27, 1982

Amount Offered:			
To the public	$5,000 million	$2,500 million	$2,500 million
Description of Security:			
Term and type of security	3-year notes	10-year notes	29-3/4-year bonds
Series and CUSIP designation	Series L-1985 (CUSIP No. 912827 MV 1)	Series A-1992 (CUSIP No. 912827 MW 9)	Bonds of 2006-2011 (CUSIP No. 912810 CY 2)
Maturity date	February 15, 1985	February 15, 1992	November 15, 2011
Call date	No provision	No provision	November 15, 2006
Interest coupon rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids	14%
Investment yield	To be determined at auction	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction	To be determined after auction
Interest payment dates	August 15 and February 15	August 15 and February 15	May 15 and November 15 (first payment on May 15, 1982)
Minimum denomination available	$5,000	$1,000	$1,000
Terms of Sale:			
Method of sale	Yield Auction	Yield Auction	Price Auction
Accrued interest payable by investor	None	None	$35.58011 per $1,000 (from November 16, 1981, to February 16, 1982)
Preferred allotment	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment to be submitted with tender	Full payment to be submit with tender
Deposit guarantee by designated institutions	Acceptable	Acceptable	Acceptable
Key Dates:			
Deadline for receipt of tenders	Tuesday, February 2, 1982, by 1:30 p.m., EST	Wednesday, February 3, 1982, by 1:30 p.m., EST	Thursday, February 4, 198 by 1:30 p.m., EST
Settlement date (final payment due from institutions)			
a) cash or Federal funds	Tuesday, February 16, 1982	Tuesday, February 16, 1982	Tuesday, February 16, 198
b) readily collectible check	Thursday, February 11, 1982	Thursday, February 11, 1982	Thursday, February 11, 19
Delivery date for coupon securities	Tuesday, February 23, 1982	Wednesday, February 24, 1982	Tuesday, February 16, 1982

File

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

January 25, 1982

Dear Mr. Speaker:

There is transmitted herewith a proposed bill, "To facilitate the management of the public debt by eliminating the limitation on the amount of the Treasury bonds issued paying interest in excess of 4-1/4 per centum."

Under legislation enacted in October 1980, the amount of Treasury marketable bonds (securities with maturities in excess of 10 years) held by the public with interest rates exceeding 4-1/4 percent may not exceed $70 billion. Currently, bonds held by the public amount to about $68.9 billion. Thus, only $1.1 billion remains of Treasury's bond issuance authority.

The $1.1 billion of remaining bond authority is not adequate to permit Treasury to continue its current practice of issuing bonds on a regular quarterly cycle in amounts totaling about $15 billion a year. Treasury must continue to issue bonds to maintain a presence in all maturity sectors of the market, and to avoid further shortening of the maturity of the public debt. About one-half of privately held marketable Treasury debt matures within one year and about two-thirds matures within two years. Such heavy reliance on short-term financing makes the Treasury particularly susceptible to short-term fluctuations in interest rates and thus in the cost of financing the debt.

Interruption of Treasury's quarterly bond cycle, because of the exhaustion of bond issuance authority, will also disrupt the market. Treasury has long been committed to a policy of regularization of debt issues, including bond issues, to reduce market uncertainties and thus Treasury borrowing costs.

The statutory 4-1/4 percent ceiling is unrealistically low and has been since the mid-1960's. Treasury's most recent bond auction (November 5) required an interest coupon of 14 percent. There is no prospect that bond market rates will fall to 4-1/4 percent in the foreseeable future.

Accordingly, the proposed legislation repeals the interest rate ceiling on marketable Treasury bonds.

We face large borrowing requirements over the foreseeable future. The enclosed legislation is essential to permit Treasury to meet these financing needs in an efficient, cost-effective manner.

The Office of Management and Budget has advised that enactment of the proposed legislation would be in accord with the program of the President.

Sincerely,

Donald T. Regan

Donald T. Regan

The Honorable
Thomas P. O'Neill, Jr.
Speaker of the House
of Representatives
Washington, D.C. 20515

Enclosure

A BILL

To facilitate the management of the public debt by eliminating the limitation on the amount of the Treasury bonds issued paying interest in excess of 4-1/4 per centum.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1 of the Second Liberty Bond Act (31 U.S.C. 752) is amended by striking out in the second paragraph "not exceeding 4-1/4 per centum, per annum," in the first sentence, and by striking out the third sentence.

January 25, 1982

Dear Mr. Speaker:

There is transmitted herewith a proposed bill, "To facilitate the management of the public debt by authorizing a flexible investment yield on United States savings bonds."

Under legislation enacted in October 1980, Treasury may increase the interest rate on savings bonds by up to one percent during any six-month period. Accordingly, Treasury increased the maximum rate on savings bonds from 7 percent to 8 percent on November 1, 1980, and to 9 percent on May 1, 1981. Treasury did not use its authority to increase the rate to 10 percent on November 1, 1981, but announced that it planned to seek legislation to permit Treasury to vary the savings bond rate with market rates.

The maximum rate increases permitted under existing law have not been sufficient to stem the savings bond cash drain from the Treasury, because of higher interest rates available from other market instruments. Savings bond redemptions exceeded sales by more than $5 billion in 1979, more than $11 billion in 1980, and approximately $8 billion in the first 10 months of 1981. These cash drains from the savings bond program must be financed by other, more expensive, Treasury borrowing, namely, the issuance of additional marketable securities at interest rates much higher than the savings bond rate.

To stem the cash drain, Treasury must assure savings bond investors that they will receive a fair rate of return throughout their holding period. Thus, Treasury must be able to promise investors that the rate on savings bonds will vary with market rates of interest.

The alternative of raising the savings bond rate to, say, 10 percent now and possibly a higher rate later, under existing legislation, was rejected by Treasury. While such rate increases might over time reduce the savings bond cash drain, they would be relatively expensive over the long run if market rates of interest declined. Also, there is no way under existing legislation that Treasury could assure long-term savers that the rate on savings bonds would continue to be competitive with current market rates. The need is for a savings bond rate that automatically increases, and decreases, with market rates. The proposed bill grants such flexibility.

We face large borrowing requirements over the foreseeable future. The enclosed legislation is essential to permit Treasury to meet these financing needs in an efficient, cost-effective manner.

The Office of Management and Budget has advised that enactment of the proposed legislation would be in accord with the program of the President.

Sincerely,

Donald T. Regan

Donald T. Regan

The Honorable
Thomas P. O'Neill, Jr.
Speaker of the House
of Representatives
Washington, D.C. 20515

Enclosure

A BILL

To facilitate the management of the public debt by authorizing a flexible investment yield on United States savings bonds.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 22 of the Second Liberty Bond Act (31 U.S.C. 757c) is amended by striking out subsections (a) and (b) thereof and inserting the following in lieu thereof:

(a) The Secretary of the Treasury, with the approval of the President, is authorized to issue United States savings bonds the proceeds of which shall be available to meet any public expenditures authorized by law, and to retire any outstanding obligations of the United States. The various issues and series of savings bonds shall be in such forms, shall be offered in such amounts, subject to the limitation imposed by section 21 of this Act, shall bear interest at such rates and shall be issued in such manner and subject to such terms and conditions as the Secretary of the Treasury may from time to time prescribe.

(b) The Secretary of the Treasury is authorized to provide by regulation:

(1) That owners of savings bonds may retain bonds and continue to earn interest for any period beyond original maturity.

(2) That the yield on savings bonds be increased for the remaining period to maturity or extended maturity, or changed for any new extension period.

Savings Bonds Legislation

* Authorizes Secretary of the Treasury to prescribe the interest rate for bonds held for at least 5 years.

* Authorizes same arrangement for bonds now being held -- they would also receive the new variable rate if that rate is higher than the fixed rates already promised.

Treasury plans to set rate at 85 percent of the average rate on 5-year Treasury securities during the holding period.

Example: If you buy a Savings Bond and redeem it after 5 years, and if the average rate for 5-year marketables during the holding period was 12.5 percent, your bond would earn 10.6 percent upon its redemption.

Why 85 percent?

(1) Savings Bonds are available in smaller minimum denominations and therefore entail higher administrative costs.

(2) Savings Bonds have tax deferral advantages which increase their effective yield after taxes (relative to marketable securities).

(3) Savings Bonds are redeemable at par, thereby eliminating the risk of market value depreciation inherent in ownership of marketable Treasury securities.

Note: Treasury feels the 85 percent rate is a fair rate of return and at the same time should be less costly to the Treasury than market financing.

Historically, Savings Bonds sales drop and redemptions rise when their return is less than 75-80 percent of market rates.

Savings Bonds have no risk. Bond holders cannot lose any of their principal when interest rates rise but prices of marketable securities drop when interest rates rise.

A new "market-based" variable rate will:

* provide needed improvement for the small saver who has been loyally participating in the program.

* provide an incentive to the nonsaver -- a reason to enroll in payroll savings.

* help our government by reducing the need for borrowing in the public money markets.

* assure Savings Bonds holders of a fair return regardless of movements in market rates of interest -- this should assure greater participation in the program.

Under current legislation, Treasury may increase the interest rate on Savings Bonds by up to 1 percent each 6 months. Accordingly, Treasury increased the maximum rate on bonds from 7 to 8 percent in 1980, and to 9 percent on May 1, 1981. Treasury did not increase the rate to 10 percent on November 1, 1981, announcing instead plans to seek new legislation to peg its rate to market rates.

Maximum rate increases permitted under existing law has not stemmed cash drain. Savings Bonds redemptions exceeded sales by over $5 billion in 1979, over $11 billion in 1980, and about $8 billion in the first 10 months of 1981. These cash drains must be financed by other, more expensive, Treasury borrowing -- namely marketable securities at interest rates much higher than the savings bonds rate.

Americans have the lowest savings rate of any industrialized nation.

* Americans save 5 percent of their personal income.
* Italy -- 24 percent
* Japan -- 20 percent
* France -- 18 percent
* Germany -- 14 percent

Today, about $68 billion in Savings Bonds are held by 23 million families.

Savings Bonds are especially designed for the small saver:

* Can put away $25 to $50 a month
* Payroll savings makes it easy to save
* Save systematically and safely
* Pay no state or local tax, defer Federal taxes on interest until redemption
* Once decision to save is made, money is taken out of check before there is a chance to spend it.
* Often it is the only way to divert funds away from demands of day to day living.
* Program built and manned by volunteers.

Savings Bonds help the general economy by "freeing up" more money for private industrial use. The $68 billion in outstanding bonds is $68 billion the government does not need to borrow from the already overcrowded securities markets.

December 1, 1981

QUESTIONS AND ANSWERS
VARIABLE-RATE SAVINGS BONDS PROPOSAL

1. Why is the Treasury changing the Savings Bond program which has been so successful for the past 40 years?

A. The Treasury recognizes its responsibility to provide bondholders with a fair deal. Bondholders should be confident that regardless of market conditions they will never be hurt because they own Savings Bonds.

2. What about all the safety, convenience and tax features of Savings Bonds which have been a traditional part of the program?

A. All features and benefits of the Savings Bonds program remain the same except for the proposal to tie the interest rate to 85 percent of the 5-year Treasury marketable rate.

3. Will the interest rate improvements apply to my outstanding bonds?

A. Yes. If bonds are held 5 years after the introduction of the new program you will receive 85 percent of the market rate or your present guaranteed rate for the bonds -- whichever is higher. If your bonds are cashed prior to 5 years you will receive the current guaranteed return for your bonds.

4. Should I wait until the new program is introduced to buy bonds or promote bonds in my company?

A. No. Both outstanding and newly sold bonds will benefit from the proposed changes.

5. Should I cash in my old bonds to buy the new bonds?

A. No. All bonds outstanding 5 years after the introduction of the program will benefit from the new rate structure.

6. What if market rates go very high -- say to 25 percent or more?

A. Regardless of how high market rates go, under the Treasury's proposal Bonds would pay 85 percent of the Treasury 5-year rate recalculated each 6 months. In the unlikely event that market rates average 25 percent in a six month period, Savings Bondholders would be credited over 21 percent interest during this period if other holding requirements are met.

7. What if market interest rates fall to very low levels -- say 3 or 4 percent?

A. Under the Treasury proposal, a floor would be established for new Savings Bonds -- see question 9. Outstanding bonds would continue to enjoy their existing guarantee of 9 percent to maturity.

8. What if I need to cash my Savings Bonds before 5 years?

A. As always Series EE Savings Bonds may be cashed anytime 6 months after purchase. Series E and EE Bonds outstanding will receive the same interest if cashed prior to 5 years as they are now guaranteed. Bonds sold after the introduction of the new program will have a graduated yield curve similar to outstanding bonds. The shape of the yield curve will be determined by economic conditions at the time the program is introduced.

9. What will the guaranteed minimum be on new bonds issued under the proposed program?

A. The guaranteed long-term minimum rate will be determined based on market conditions at the time the proposed program is introduced.

10. What is the timetable for the proposed improvements in Savings Bonds interest rates?

A. The timetable depends upon the actions of Congress. A bill will be introduced in Congress this year. Congressional staffs indicate that hearings will be held early next year with approval not expected until February 1982 at the earliest.

11. How often will the 85-percent-of-market-rates be determined?

A. The rate will be calculated every six months, based on the average for the previous period. For example, say you buy a bond after the new, variable rate is in effect and hold it for 7 years (14 six-month periods). The 14 different interest periods will be averaged and the result will be the rate for the entire time you hold the bond -- assuming this is higher than the guaranteed minimum.

12. How about compounding the interest? How is that done?

A. Interest on these bonds will be compounded semiannually on the basis of the rate for the entire period, as described above.

13. What rate will apply to Savings Notes (Freedom Shares) and to Series H and HH Bonds?

A. Savings Notes will pay the same as for Series E and EE Bonds. The Treasury intends to modernize the rate structure for H and HH Bonds also but details are not yet available.

TREASURY AND STATE DEPARTMENT BACKGROUND PAPER ON POLAND'S FINANCIAL AND ECONOMIC SITUATION FOR THE EUROPEAN SUBCOMMITTEE OF THE SENATE FOREIGN RELATIONS COMMITTEE

WEDNESDAY, JANUARY 27, 1982

Poland's Economic Strategy for the 1970's

In the early 1970's, Poland embarked on an ambitious economic development strategy to modernize its economy and to increase substantially its living standards. The strategy envisaged a simultaneous expansion in investment and consumption. This could only be undertaken with foreign borrowing, primarily from the West.

Massive increases in investment were needed to reorient the economy away from inefficient import substitution. Priority emphasis was given to investment in heavy industry, a strategy in which imports of capital equipment from the West figured prominently. Restructuring the economy also required the introduction of substantial inputs of Western technology to increase the overall efficiency of the productive process. Further, the Polish planners believed it was necessary to develop a viable export sector to enable Poland to sell its products in Western markets.

In order to achieve these increases in output and increased efficiencies, the Polish authorities felt that Polish workers needed added incentives to stimulate the growth of output. To this end, substantial increases were planned in both the quality and quantity of goods which were made available to the Polish consumer to render effective the enhanced monetary incentives which were offered. It was seen as particularly important to improve the diet of the Polish worker. Accordingly, a sharp increase in food production and food supplies, especially meat, were planned for by use of appropriate pricing incentives for the large private farm sector. In so doing, Polish authorities also hoped to avoid a repetition of the food riots of December 1970, and their disruptive effects on the economy and society.

The Polish planners believed that access to Western credits and technology would permit a rapid expansion of modern, competitive, efficiently produced products. These goods were to be produced in new, or newly modernized, plants utilizing modern Western machinery. They were to produce in accordance with Western standards, and in some cases, under licensing arrangements with the leading industrial firms of the West. In this strategy, it was expected that

Polish products would be sold in Western markets and the trade deficit, which would be incurred to obtain the productive inputs from the West, would soon shift to a trade surplus, enabling the Poles to repay their hard currency debts.

Early Results

While the Polish economy registered some impressive gains in the early 1970's with real economic growth averaging 6 percent per annum. However, it became apparent by the middle part of the decade that the strategy was encountering major difficulties.

The main problems stem from the fact that Polish authorities made a number of policy errors. For example, when the Western recession began in 1974, most East European countries cut back their hard currency imports from the West. The Poles, however, like a number of developing and industrial countries, continued to adhere to their ambitious development plan and maintained a rapid rate of increased imports to build their new industrial capacity. As a result, Poland's trade deficit with the West widened. By year-end 1975, this deficit exceeded $2 billion. Between 1975 and 1980, Poland's cumulative current account deficit with the West amounted to a massive $18 billion.

Incorrect income and pricing policies were also responsible for Poland's economic problems. In particular, the Polish planners tried to insulate the economy from the inflationary pressures of the mid-1970's by utilizing subsidies, price controls, and taxes. These measures increased the degree of distortion which already existed in the price structure and exacerbated the financial situation of enterprises as well. Ultimately, these distortions reduced the ability of productive sectors of the Polish economy to compete in world markets.

The recession of the industrialized Western countries impacted severely on Poland's economy, as it did on other economies which geared their growth in large part to exports to the West. For example, in the three year period 1971-1974, Poland's exports to the West increased at an average annual rate of 32 percent in nominal terms; in the period 1974-1977, exports increased at an average annual rate of 11 percent.

Contributing to these problems were Poland's export constraints arising out of inadequate marketing, servicing (including providing replacement parts), and advertising expertise. Also, the Poles did not develop a system of export incentives to induce managers to produce for export. The existing system favored domestic production because managers found it easier to meet planners' goals and obtain bonuses by producing for domestic consumption rather than meeting export goals which often involved more complex quality standards and were more difficult to achieve.

Poor harvests brought on by six consecutive years of bad weather and inappropriate agricultural policies compounded Poland's economic malaise. The emphasis on the expansion of heavy industry had resulted in a neglect of agriculture. Moreover, Poland's agricultural sector was highly vulnerable to poor weather.

The above elements combined to produce a 5 percent average annual rate of decline in real national income between 1979 and 1981, after 8 years of rapid growth. During this period Poland, and other Eastern European membrs of the Soviet bloc, ran large trade deficits with the USSR. The Soviets also provided subsidies to Poland and those other countries through sales of oil and raw materials to them at prices below world market levels. These subsidies to the Eastern European bloc members averaged $5-6 billion in the mid- and late seventies, rising to $10 billion in 1979 and $22 billion in 1980.

Polish Debt Accumulation and Debt Rescheduling

Beginning in the early 1970's, the Poles financed a large portion of their economic growth by borrowing from the West, enjoying relatively easy access to Western capital markets. As their development plans began to falter, they became less able to service their debt.

In 1972, Poland's gross hard currency debt totaled $1.6 billion. Its debt service, consisting of $200 million of principal and $74 million of interest, amounted to only 15 percent of its foreign exchange earnings from exports of goods and services to non-communist countries. Poland's imports from non-Communist countries exceeded its exports to these countries by $1.3 - 3.3 billion annually between 1973 and 1979 as the authorities continued to pursue their development program. By 1979, Poland's external hard currency debt stood at $21 billion and its debt service ($3.6 billion in principal and $2.2 billion in interest payments) equalled 92 percent of its hard currency export earnings. By mid-year 1981, Poland's hard currency debt stood at approximately $26 billion. It owed roughly $20 billion of this to sixteen western countries, $11 billion to official creditors or guaranteed by them, including $1.9 billion to the U.S. Government; and $9 billion of unguaranteed debt to private banks including $1.3 billion to U.S. banks.

At the beginning of 1981, it was estimated that Poland would require some $11 billion in hard currency financing to cover its projected trade deficit for 1981 and to service its debt. Poland was clearly not in a position to raise such sums and on March 26, 1981, Poland notified its creditors that it would no longer be able to guarantee payment of its external debts.

The governments and private banks responded to the Poles by agreeing to enter into debt rescheduling negotiations. Separate debt rescheduling exercises were organized by the official and private creditors. Fifteen official creditor nations (later increased to 16 with the addition of Spain) concluded negotiations with the Government of Poland and a multilateral debt rescheduling agreement was signed in Paris on April 27, 1981. This agreement serves as an umbrella agreement for subsequent Government to Government agreements to reschedule 90 percent of Poland's debt service obligations to these creditors both the principal and interest falling due during the last three-quarters of 1981. These obligations, totaling $2.4 billion, are to be repaid during a four year preiod beginning in 1985. Interest on the rescheduled interest is to be charged during the grace period, 1981-1985. The U.S./Poland Government to Government agreement was signed on August 27, 1981.

Western banks, moving on a parallel track, established a consortium to negotiate a debt rescheduling agreement with the Polish Government by September. The consortium reached an ad referendum agreement with the Poles for rescheduling 95 percent of the principal ($2.3 billion) of their debt falling due during April-December 1981, over eight years, including a four year grace period.

The consortium of Western banks set a precondition for signing the document, namely that Poland pay all of the 1981 interest -- an estimated $700 million -- which fell due in the last 9 months of 1981. The Government of Poland could not completely fulfill this condition at year's end, and as a result, the Western banks did not sign the rescheduling agreement.

Current Status of Poland's External Hard Currency Debt

In 1981, in an effort to meet the condition of being current on interest payments to the banks, Poland made some payments to reduce its arrearages. In December, Poland requested that the banks provide a short-term loan which would be used to pay off remaining interest arrearages. This the banks refused to do, continuing to insist on repayment in full of all 1981 interest.

Official creditors agreed in November not to begin negotiations on rescheduling Poland's 1982 debt service until Poland signs its 1981 rescheduling agreement with the commercial banks. Following the imposition of martial law, the NATO Ministerial meeting of January 11, called for a suspension of consideration of debt rescheduling negotiations for the time being. The official creditors, including the U.S., met January 14 and agreed that rescheduling negotiations will be held in abeyance.

(N.B.: In addition, the allies have stopped new commercial credits and restricted food exports, except humanitarian assistance, to Poland. The U.S. has also taken unilateral measures to put pressure on Poland and the USSR. We have suspended Polish airline landing rights and fishing rights. With respect to the Soviets, we have: suspended the sale of oil and gas equipment and technology; suspended action on validated export licenses for high technology; suspended negotiations on a maritime agreement; suspended Aeroflot service to the U.S.; postponed negotiations on a new grains agreement; closed the KAMA Purchasing Commission; and not renewed the scientific exchange agreement. Our allies have taken and are considering further actions to support and complement these U.S. measures, with the common objective of putting and keeping pressure on the Polish and Soviet governments to permit the process of reform to continue in Poland.

In this regard, we and our allies agree that one facet of this pressure is to continue to try to hold Poland to its debt obligations to the West. This puts the Polish government under significant economic pressure. The suspension of consideration of negotiations on rescheduling 1982 Polish debt allows us to pursue the collection of those debts.)

Outlook

Prior to the events of December 13, Poland's economic and financial outlook was extremely grave. GNP declined by about 15 percent in 1981, and shortages of spare parts and raw materials, because of the inability of the GOP to obtain Western financing, presaged even further declines without significant economic reforms.

The Polish government, prior to the military crackdown, had designed an initial economic reform and stabilization program aimed at reversing the decline and eventually resuscitating Poland's finances. While progress was slower than many had hoped, that government and Solidarity were beginning a dialogue to bring about economic improvement. Such a dialogue is, in our view, the only way we believe that improvement would have been viable over time. According to the plan provided by that Polish Government to the Western creditors, in November 1981, Poland would work to balance its hard currency trade in 1982; an export surplus would have grown steadily in succeeding years. By 1985, the plan projected Poland's export surplus would be large enough to cover its interest payments, thereby eliminating the current account deficit and Poland's need to borrow in that year. After 1985, this plan projected a trade surplus large enough for the Poles to begin reducing their outstanding stock of debt. This projected scenario would have required that Poland be able to borrow new funds from Western governments and/or banks until 1986 with the sums needed declining annually. The amounts it would have needed to borrow could have been reduced through continued debt rescheduling. The need for new financing would have been greatest in 1982. Even under this projection, Poland's debt service payments would have risen again in 1986 when the debt rescheduled in 1981 begins to falls due.

The Poles developed this projection before the imposition of martial law. Now it is quite difficult, if not impossible, to assess what path the Polish economy will take because of the repression of the Polish workers, whose support is needed for lasting economic improvement to take place, and the economic and social disruptions introduced by martial law.

Fact Sheet on Polish Debt

-- Poland has an external hard currency debt of approximately $26 billion; government and government-guaranteed debt is some $17 billion; private unguaranteed debt is some $9 billion.

-- Of this amount, roughly $20 billion is due to sixteen western countries.

-- Polish debt to the United States totals some $3.15 billion, which is 14% of the total $26 billion.

The breakdown of this figure is:

Non-guaranteed loans from private creditors (Primarily commercial banks)	1.3
Direct credits and guarantees by Commodity Credit Corporation	1.6
Export-Import Bank Loan	.244
AID Loan	.006

-- Governments of sixteen western countries including U.S., U.K., France, West Germany, Japan, Canada, Switzerland, the Netherlands, signed a multilateral agreement in April 1981 to reschedule 90 percent of the principal and interest falling due from May 1981 to December 1981. The U.S. share of this was $380 million. The official rescheduling totalled $2.3 billion.

-- Repayment terms provided for four years grace and four years repayment, the latter commencing in 1986.

-- These terms are generally comparable to those of other countries who have found it necessary to reschedule their debts.

-- In response to the Polish repression in December, the official creditors recently agreed to hold negotiations with the Poles on their 1982 debt service in abeyance pending a normalization of the situation. They also decided that in any event they would continue to adhere to their longstanding understanding that they will not discuss the 1982 debt until Poland signs a rescheduling agreement on its 1981 debt with the commercial banks.

-- The commercial banks of the sixteen western countries have been negotiating a debt rescheduling agreement with Poland.

-- The terms of this agreement as we understand them -- providing for rescheduling 95 percent of principal only, $2.3 billion -- appear to be comparable to those provided by Poland's official creditors.

-- It is also our understanding that the government of Poland must pay all interest due to the commmercial banks prior to signing of that agreement.

-- We have heard that this amount is now on the order of $250 million. We are in no position to comment one way or another as to whether the Poles will meet this payment.

-- Total debt outstanding to all banks is around $15-16 billion; about $14 1/2 billion was recorded as of June 1981 for those banks in the reporting system of the Bank for International Settlements. However, much of this would be guaranteed by creditor governments. After allowance for guarantees, the commercial bank debt is thought to be around $9 billion.

-- The precise amount of banks' guarantee-adjusted exposure in individual countries is reported regularly only for U.S. and U.K. banks (exposure in Poland of $1.3 billion and $1.0 billion, respectively, as of mid-1981). Around 60 U.S. banks account for the $1.3 billion, most of which report amounts equal to less than 5 percent of their capital, broadly defined

-- Continental banks have a relatively greater exposure in Poland The degree of exposure varies among individual banks. Some figures have appeared in the press, but we cannot attest to their authenticity.

-- As for 1982 maturities, we estimate that Poland's debt service obligations to official and private creditors for 1982 total roughly $10.4 billion -- $6.8 billion in principal, $2.8 billion in interest, and $0.8 billion interest due on the rescheduled 1981 debt.

Poland

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 (estimate)
				(billions of U.S. $)						
Non-Communist										
a)Exports	1.8	2.5	3.9	4.1	4.4	4.9	5.5	6.3	7.4	5.6
b)Imports	2.0	4.0	6.0	7.4	7.5	7.1	7.5	8.8	8.8	6.5
c)Trade balance	-0.2	-1.5	-2.1	-3.3	-3.1	-2.2	-2.0	-2.5	-1.4	-0.9
Gross Debt	1.6	2.8	4.6	8.0	11.5	14.0	17.8	21.1	25.0	26.0
Principal Repayment	0.2	0.3	0.5	0.7	1.2	2.0	2.9	3.6	5.6	6.4
Interest	0.1	0.2	0.4	0.5	0.7	0.9	1.5	2.2	2.4	3.3
Debt Service (as % of exports)	15	19	23	30	42	59	79	92	108	173

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
Wednesday, January 27, 1982

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TREASURY ANNOUNCES RELEASE OF PUBLICATIONS FROM CUBA

The Treasury Department announced today that it has authorized the U.S. Customs Service in Boston to release to addressees about 100,000 single copies of Cuban publications.

Under instructions filed with the Federal Register, anybody will be able to import into the U.S. single copies of publications from Cuba, North Korea, Vietnam or Kampuchea or to take out single subscriptions to periodicals from those countries without restriction as to method of payment. "Publications" includes books, newspapers, magazines, films phonograph records, tapes, photographs, microfilm, microfiche, posters and similar materials. Multiple subscriptions will still require a special license from the Office of Foreign Assets Control (OFAC).

OFAC's instructions are the result of a policy review that was instituted when the retention of publications from Cuba by the U.S. Customs Service in Boston caused complaints from several intended recipients. The Treasury Department expects that the new policy will represent a satisfactory resolution of concerns raised by several groups this past fall on a suit brought against the government in the Federal District Court of Massachusetts.

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R-587

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

FOR IMMEDIATE RELEASE January 29, 1982

FEDERAL FINANCING BANK ACTIVITY

Francis X. Cavanaugh, Acting Secretary, Federal Financing Bank (FFB), announced the following activity for the month of December 1981.

FFB holdings of obligations issued, sold, or guaranteed by other Federal agencies on December 31, 1981 totaled $110.7 billion, an increase of $1.2 billion over the November 30 level. FFB increased holdings of agency debt issues by $0.5 billion and holdings of agency guaranteed debt by $0.9 billion while reducing holdings of agency assets purchased by $0.2 billion. A total of 249 disbursements were made during the month.

Attached to this release is a table outlining FFB loan activity during December, a table outlining new FFB commitments to lend and a table summarizing FFB holdings as of December 31, 1981.

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R-588

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF DEFENSE					
Ecuador 4	12/1	$312,762.00	7/25/87	12.791%	
Israel 11	12/1	16,132,170.52	2/16/11	13.168%	
Jordan 5	12/1	818,402.42	3/30/88	12.809%	
Peru 5	12/1	72,656.13	3/15/86	12.701%	
Peru 6	12/1	1,543,000.00	1/15/87	12.766%	
Philippines 6	12/1	1,951,993.57	7/21/85	12.625%	
Israel 11	12/7	24,808,937.70	2/16/11	13.170%	
Egypt 1	12/8	2,489,680.75	9/1/09	13.538%	
Gabon 3	12/8	650,000.00	5/4/87	12.714%	
Greece 13	12/8	39,750.00	9/22/90	13.319%	
Jordan 5	12/8	1,135,927.14	3/30/88	13.185%	
Liberia 6	12/8	31,367.90	3/21/86	13.033%	
Morocco 7	12/8	125,000.00	7/21/88	13.204%	
Turkey 6	12/8	23,707.35	6/3/88	13.200%	
Turkey 8	12/8	27,630.29	6/15/10	13.532%	
Turkey 9	12/8	918,990.00	6/22/92	13.470%	
Turkey 11	12/8	54,739.36	12/22/10	13.528%	
Turkey 12	12/8	61,950.00	5/5/11	13.526%	
Peru 6	12/9	478,000.00	1/15/87	13.330%	
Cameroon 2	12/9	679,641.95	5/10/85	12.936%	
Cameroon 3	12/9	351,847.70	9/22/86	13.090%	
Morocco 7	12/9	1,390,235.00	7/21/88	13.221%	
Peru 5	12/9	89,860.00	3/15/86	13.061%	
Turkey 2	12/9	152,597.74	10/1/86	13.115%	
Turkey 4	12/9	2,583,440.13	10/1/87	13.130%	
El Salvador 1	12/10	35,625.00	6/2/90	13.516%	
El Salvador 2	12/10	323,405.00	12/2/90	13.557%	
Panama 3	12/11	850,000.00	11/15/84	13.225%	
Philippines 6	12/11	905,382.28	7/21/85	13.492%	
Philippines 7	12/11	428,978.51	9/10/87	13.685%	
Israel 8	12/14	19,000,000.00	9/1/09	13.868%	
Dominican Republic 2	12/15	669,879.80	8/5/88	13.645%	
Dominican Republic 4	12/15	544,845.11	8/5/88	13.645%	
Israel 11	12/15	12,800,000.00	2/16/11	13.634%	
Morocco 8	12/15	20,365,138.48	9/21/93	13.721%	
Sudan 2	12/15	3,914,930.00	6/3/10	13.642%	
Sudan 3	12/15	2,564,344.34	2/24/11	13.693%	
Thailand 3	12/15	14,362.00	9/20/84	13.457%	
Thailand 6	12/15	67,741.00	9/20/85	13.584%	
Thailand 7	12/15	144,617.96	8/25/86	13.610%	
Morocco 7	12/16	26,882.69	7/21/88	13.433%	
Peru 5	12/16	14,141.57	3/15/86	13.360%	
Egypt 1	12/17	767,867.13	9/1/09	13.581%	
Jordan 5	12/17	738,979.90	3/30/88	13.424%	
Jordan 6	12/17	8,687,976.60	9/21/92	13.562%	
Sudan 3	12/17	321,684.43	2/24/11	13.569%	
Jamaica 1	12/18	179,776.34	3/1/93	13.762%	
Korea 14	12/18	588,710.00	6/30/93	13.765%	
Sudan 2	12/18	1,796,468.57	6/3/10	13.755%	
Tunisia 8	12/18	271,190.00	7/10/88	13.648%	
Turkey 6	12/18	154,106.44	6/3/88	13.648%	
Peru 7	12/18	48,547.00	2/15/88	13.682%	
Lebanon 2	12/21	4,189,406.00	4/15/86	13.463%	
Lebanon 3	12/21	1,444,552.00	7/25/87	13.490%	
Oman 4	12/21	9,168,965.49	5/10/89	13.504%	
Thailand 7	12/21	38,255.11	8/25/86	13.485%	
Honduras 7	12/22	208,750.00	9/25/91	13.977%	
Turkey 6	12/22	289,662.56	6/3/88	13.930%	
Turkey 9	12/22	502,478.00	6/22/92	13.971%	
Kenya 8	12/22	1,191,933.55	3/3/92	13.955%	
Spain 4	12/22	166,433.50	4/25/90	13.938%	
Spain 5	12/22	117,284.68	6/15/91	13.960%	
Greece 12	12/22	1,055,000.00	6/3/10	13.853%	
Egypt 1	12/22	15,803,458.01	9/1/09	13.863%	
Korea 14	12/23	2,350,937.40	6/30/93	14.156%	
Dominican Republic 4	12/28	34,566.79	8/5/88	14.152%	
Greece 13	12/28	2,532,931.66	9/22/90	14.146%	
Turkey 7	12/28	807,330.00	6/3/91	14.161%	
Israel 11	12/28	46,195,045.82	2/16/11	14.043%	

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF DEFENSE (Cont'd)					
Kenya 9	12/29	$4,782,650.45	3/15/93	14.155%	
Egypt 1	12/30	4,184,807.73	9/1/09	14.173%	
Jamaica 1	12/30	1,084.47	3/1/93	14.237%	
Jordan 5	12/30	360,885.71	3/30/88	14.209%	
Jordan 6	12/30	1,968,849.61	9/21/92	14.236%	
Niger 1	12/30	913,091.10	3/1/88	14.239%	
Thailand 8	12/30	3,900,000.00	8/10/90	14.240%	
Cameroon 3	12/31	35,259.00	9/22/86	14.117%	
Greece 12	12/31	379,630.00	6/3/10	14.229%	
Honduras 7	12/31	1,187,648.60	9/25/91	14.220%	
Sudan 3	12/31	40,706.46	2/24/11	14.219%	
DEPARTMENT OF ENERGY					
Synthetic Fuels Guarantees - Defense Production Act					
TOSCO #5	12/7	2,484,102.80	10/1/07	13.190%	
TOSCO #6	12/14	2,519,743.88	10/1/07	13.889%	
TOSCO #7	12/21	1,715,326.65	10/1/07	13.583%	
TOSCO #8	12/28	3,934,295.96	10/1/07	14.082%	
EXPORT-IMPORT BANK					
Note #37	12/1	317,900,000.00	12/1/91	13.255%	13.042% qtr.
Note #38	12/1	460,000,000.00	12/1/91	12.835%	12.635% qtr.
GENERAL SERVICES ADMINISTRATION					
Series M-080	12/8	292,713.88	7/31/03	13.233%	
DEPARTMENT OF HEALTH & HUMAN SERVICES					
Health Maintenance Organization Notes					
Block #19	12/14	571,194.10	various	13.911%	
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT					
Community Development Block Grant Guarantees					
Washington County, Pennsylvania	12/2	346,715.06	9/15/82	12.125%	12.391% ann.
Louisville, Kentucky	12/4	1,400,000.00	11/30/82	12.345%	12.726% ann.
Washington County, Pennsylvania	12/11	288,587.38	9/15/82	12.545%	12.743% ann.
Sioux Falls, South Dakota	12/15	142,600.00	2/1/82	11.705%	
Lawrence, Massachusetts	12/15	165,000.00	1/1/82	11.705%	
Gary, Indiana	12/15	300,000.00	9/1/82	12.835%	13.002% ann.
Syracuse, New York	12/18	75,000.00	7/1/02	13.821%	14.299% ann.
Public Housing Authority Project Bonds					
Sale #16	12/4	117,526,094.19	various	13.397%	13.046% ann.
DEPARTMENT OF THE INTERIOR					
*Guam Power Authority	12/31	36,000,000.00	12/31/90	14.255%	
RURAL ELECTRIFICATION ADMINISTRATION					
Associated Electric #132	12/1	9,000,000.00	12/1/83	12.485%	12.296% qtr.
Basin Electric #87	12/1	967,000.00	12/1/83	12.485%	12.296% "
Western Farmers Electric #195	12/1	4,000,000.00	12/1/83	12.485%	12.296% "
Arkansas Electric #142	12/1	3,713,000.00	12/1/83	12.485%	12.296% "
Plains Electric #158	12/1	16,022,000.00	12/1/83	12.485%	12.296% "
Saluda River Electric #186	12/1	1,000,000.00	12/1/83	12.485%	12.296% "
South Mississippi Electric #171	12/1	3,500,000.00	12/2/83	12.485%	12.296% "
Corn Belt Power #55	12/2	125,000.00	12/2/83	12.835%	12.635% "
Basin Electric #137	12/3	20,000,000.00	12/2/83	14.835%	12.635% "

*Maturity extension

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
Glacier State Telephone #181	12/3	$2,424,000.00	12/3/83	13.015%	12.810% "
*State Texas Electric #109	12/3	1,100,000.00	12/3/83	13.015%	12.810% "
*Colorado Ute Electric #78	12/3	2,436,000.00	12/3/83	13.015%	12.810% "
*Ogden Telephone #72	12/4	750,000.00	12/4/83	13.005%	12.800% "
Alabama Electric #26	12/4	425,000.00	12/4/83	13.005%	12.800% "
Seminole Electric #141	12/4	8,765,000.00	12/4/83	13.005%	12.800% "
East Kentucky Power #188	12/4	10,110,000.00	12/4/83	13.005%	12.800% "
Sho-Me Power #164	12/4	668,000.00	12/4/83	13.005%	12.800% "
*East Ascension Telephone #39	12/5	492,000.00	12/5/83	12.355%	12.170% "
*Sugarland Telephone #69	12/5	1,463,000.00	12/5/83	12.355%	12.170% "
*United Power #67	12/5	200,000.00	12/5/83	12.355%	12.170% "
*United Power #129	12/5	2,600,000.00	12/5/83	12.355%	12.170% "
*East Kentucky Power #140	12/6	9,480,000.00	12/6/83	12.355%	12.170% "
Wolverine Electric #190	12/7	148,000.00	12/7/83	12.355%	12.170% "
Southern Illinois Power #38	12/7	375,000.00	12/7/84	12.875%	12.674% "
Upper Missouri G&T #172	12/8	345,000.00	12/8/83	12.705%	12.509% "
Colorado Ute Electric #152	12/9	1,045,000.00	12/9/83	12.775%	12.577% "
San Miguel Electric #205	12/9	12,100,000.00	12/9/83	12.775%	12.577% "
Northern Michigan Electric #101	12/10	220,000.00	12/10/83	12.995%	12.391% "
Northern Michigan Electric #183	12/10	3,713,000.00	12/10/83	12.995%	12.391% "
Wabash Valley Power #104	12/10	5,302,000.00	12/10/83	12.995%	12.391% "
Wolverine Electric #182	12/10	2,958,000.00	12/10/83	12.995%	12.391% "
Copper Valley Electric #125	12/10	1,586,000.00	12/31/83	13.035%	12.829% "
Allegheny Electric #175	12/10	5,668,000.00	12/31/84	13.515%	13.294% "
*Wolverine Electric #100	12/10	1,079,000.00	12/10/83	12.995%	12.791% "
*Colorado Ute Electric #8	12/10	3,500,000.00	12/31/09	13.618%	13.394% "
Alabama Electric #26	12/10	5,567,000.00	12/11/83	13.285%	13.071% "
*Central Electric Power #100	12/14	177,000.00	12/14/83	13.475%	13.255% "
*Western Illinois Power #99	12/14	2,342,000.00	12/14/83	13.475%	13.255% "
*Colorado Ute Electric #8	12/14	382,000.00	12/14/83	13.475%	13.255% "
*Colorado Ute Electric #78	12/14	3,293,000.00	12/14/83	13.475%	13.255% "
Soyland Power #165	12/14	9,201,000.00	12/14/83	13.475%	13.255% "
Wabash Valley Power #206	12/14	162,000.00	12/14/83	13.475%	13.255% "
Western Illinois Power #162	12/15	3,535,000.00	12/15/83	13.515%	13.294% "
New Hampshire Electric #192	12/15	2,460,000.00	12/15/83	13.515%	13.294% "
Tri-State G&T #157	12/15	500,000.00	11/30/88	13.685%	13.459% "
Chugach Electric #204	12/16	1,277,000.00	12/31/15	13.486%	13.266% "
Colorado Ute Electric #96	12/17	3,720,000.00	12/17/83	13.165%	12.955% "
Seminole Electric #141	12/17	10,548,000.00	12/17/83	13.165%	12.955% "
Oglethorpe Power #74	12/17	33,558,000.00	12/17/83	13.165%	12.955% "
Oglethorpe Power #150	12/17	30,506,000.00	12/17/83	13.165%	12.955% "
Cajun Electric #76	12/18	20,000,000.00	12/18/83	13.495%	13.275% "
Cajun Electric #197	12/18	10,000,000.00	12/18/83	13.495%	13.275% "
*Associated Electric #132	12/19	11,950,000.00	12/19/83	13.315%	13.100% "
*Big Rivers Electric #58	12/21	519,000.00	12/21/83	13.315%	13.100% "
*Big Rivers Electric #91	12/21	2,230,000.00	12/21/83	13.315%	13.100% "
Big Rivers Electric #91	12/21	258,000.00	12/21/83	13.315%	13.100% "
*Big Rivers Electric #136	12/21	483,000.00	12/21/83	13.315%	13.100% "
Big Rivers Electric #136	12/21	15,000.00	12/21/83	13.315%	13.100% "
Big Rivers Electric #143	12/21	60,000.00	12/21/83	13.315%	13.100% "
Big Rivers Electric #179	12/21	18,173,000.00	12/21/83	13.315%	13.100% "
Central Electric #131	12/22	140,000.00	12/22/83	13.735%	13.507% "
Continental Tel. of the So. #106	12/22	5,500,000.00	12/31/15	13.729%	13.501% "
Continental Tel. of the So. #134	12/22	1,000,000.00	12/31/15	13.729%	13.501% "
Continental Tel. of the So. #135	12/22	500,000.00	12/31/15	13.729%	13.501% "
Wabash Valley Power #206	12/22	748,000.00	12/23/83	13.895%	13.662% "
Brazos Electric #108	12/22	1,931,000.00	12/23/83	13.895%	13.662% "
Brazos Electric #144	12/22	3,824,000.00	12/23/83	13.895%	13.662% "
South Texas Electric #109	12/26	1,500,000.00	12/26/83	14.075%	13.836% "
*Colorado Ute Electric #78	12/26	4,055,000.00	12/26/83	14.075%	13.836% "
*East Kentucky Power #73	12/26	6,237,000.00	12/26/83	14.075%	13.836% "
Soyland Power #105	12/27	9,243,000.00	12/27/83	14.075%	13.836% "
*Basin Electric #88	12/27	820,000.00	12/27/84	14.295%	14.048% "
Colorado Ute Electric #168	12/28	13,130,000.00	12/28/83	14.085%	13.845% "
Quaker State Telephone #92	12/28	1,500,000.00	12/28/83	14.085%	13.845% "
West Virginia Telephone #17	12/28	718,000.00	12/28/83	14.085%	13.845% "
*Brazos Electric #144	12/28	49,503,646.75	12/28/83	14.085%	13.845% "
*St. Joseph Tel. & Tel. #13	12/28	245,000.00	12/28/83	14.085%	13.845% "

*Maturity extension

DECEMBER 1981 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
Colorado Ute Electric #152	12/29	$22,335,000.00	12/29/83	14.145%	13.903% qtr.
Colorado Ute Electric #198	12/29	8,565,000.00	12/29/83	14.145%	13.903% "
East River Electric #117	12/29	1,250,000.00	12/29/83	14.145%	13.903% "
Deseret G&T #211	12/29	67,692,000.00	1/3/84	14.145%	13.903% "
Colorado Ute Electric #198	12/30	2,690,000.00	12/30/83	14.105%	13.865% "
South Texas Electric #200	12/30	1,059,000.00	12/30/83	14.105%	13.865% "
North Carolina Electric #185	12/30	25,505,000.00	12/30/83	14.105%	13.865% "
Northern Michigan Electric #183	12/31	5,452,000.00	12/31/83	14.025%	13.787% "
Continental Tel. of Texas #119	12/31	1,819,000.00	12/31/83	14.025%	13.787% "
Basin Electric #87	12/31	1,001,000.00	12/31/83	14.025%	13.787% "
Arkansas Electric #142	12/31	7,561,000.00	12/31/83	14.025%	13.787% "
Seminole Electric #141	12/31	9,126,000.00	12/31/83	14.025%	13.787% "
Saluda River Electric #186	12/31	8,640,000.00	12/31/83	14.025%	13.787% "
Big Rivers Electric #179	12/31	4,736,000.00	12/31/83	14.025%	13.787% "
Wabash Valley Power #104	12/31	6,327,000.00	12/31/83	14.025%	13.787% "
Wolverine Electric #182	12/31	4,869,000.00	12/31/83	14.025%	13.787% "
New Hampshire Electric #192	12/31	51,000.00	12/31/83	14.025%	13.787% "
South Mississippi Electric #171	12/31	8,934,000.00	1/1/84	14.195%	13.952% "
Allegheny Electric #175	12/31	8,378,000.00	1/31/84	14.045%	13.807% "
Cooperative Power #70	12/31	1,600,000.00	12/31/84	14.195%	13.952% "
Arizona Electric #60	12/31	5,932,000.00	12/31/15	14.064%	13.825% "
Kansas Electric #216	12/31	48,000,000.00	12/31/83	14.025%	13.787% "
Kansas Electric #216	12/31	48,000,000.00	12/31/84	14.195%	13.952% "
*Golden Valley Electric #81	12/31	750,000.00	12/31/83	14.025%	13.787% "
*Allegheny Electric #93	12/31	5,467,000.00	12/31/84	14.195%	13.952% "
*South Mississippi Electric #3	12/31	85,000.00	12/21/84	14.195%	13.952% "
*Corn Belt Power #55	12/31	232,000.00	12/31/83	14.025%	13.787% "
*Corn Belt Power #94	12/31	448,000.00	12/31/83	14.025%	13.787% "
*Wolverine Electric #100	12/31	1,934,000.00	12/31/83	14.025%	13.787% "
*Continental Tel. of Missouri #68	12/31	2,490,000.00	12/31/83	14.025%	13.787% "
*Continental Tel. of Missouri #68	12/31	2,466,000.00	12/31/83	14.025%	13.787% "
Basin Electric #87	12/31	254,000.00	12/31/83	14.025%	13.787% "
Basin Electric #137	12/31	30,000,000.00	12/31/83	14.025%	13.787% "
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
San Antonio LDC, Inc.	12/9	61,000.00	12/1/96	13.558%	
Bay Area EDC	12/9	116,000.00	12/1/96	13.558%	
Louisville EDC	12/9	196,000.00	12/1/96	13.558%	
The LDC for Buffalo, N.Y.	12/9	230,000.00	12/1/96	13.558%	
Ocean State BDA, Inc.	12/9	500,000.00	12/1/96	13.558%	
Ocean State BDA, Inc.	12/9	30,000.00	12/1/01	13.597%	
Ocean State DBA, Inc.	12/9	40,000.00	12/1/01	13.597%	
Forward Development Corp.	12/9	110,000.00	12/1/01	13.597%	
Allentown EDC	12/9	111,000.00	12/1/01	13.597%	
New Orleans Citywide DC	12/9	139,000.00	12/1/01	13.597%	
Bay Area EDC	12/9	140,000.00	12/1/01	13.597%	
South Shore EDC	12/9	156,000.00	12/1/01	13.597%	
Plymouth IDC	12/9	330,000.00	12/1/01	13.597%	
Long Island DC	12/9	498,000.00	12/1/01	13.597%	
Ocean State BDA, Inc.	12/9	135,000.00	12/1/06	13.516%	
ED Foundation of Sacramento	12/9	174,000.00	12/1/06	13.516%	
Small Business Investment Company Debentures					
Asset Management Cap. Co.	12/23	1,000,000.00	12/1/84	14.075%	
Beneficial Cap. Corp.	12/23	600,000.00	12/1/84	14.075%	
Fluid Cap. Corp.	12/23	1,000,000.00	12/1/84	14.075%	
Washington Cap. Corp.	12/23	1,450,000.00	12/1/86	13.995%	
Equilease Cap. Corp.	12/23	500,000.00	12/1/88	13.955%	
Boston Hambro Cap. Co.	12/23	1,000,000.00	12/1/91	13.955%	
BT Cap. Corp.	12/23	1,000,000.00	12/1/91	13.955%	
Equilease Cap. Corp.	12/23	500,000.00	12/1/91	13.955%	
Edwards Cap. Co.	12/23	600,000.00	12/1/91	13.955%	
First Idaho Venture Cap. Corp.	12/23	500,000.00	12/1/91	13.955%	
First Midwest Cap. Corp.	12/23	700,000.00	12/1/91	13.955%	
Intercapco, Inc.	12/23	1,500,000.00	12/1/91	13.955%	
Northwest Growth Fund, Inc.	12/23	3,000,000.00	12/1/91	13.955%	
UST Capital Corp.	12/23	200,000.00	12/1/91	13.955%	

FEDERAL FINANCING BANK

DECEMBER 1981 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
SPACE COMMUNICATIONS COMPANY (NASA Guaranteed)					
	12/21	$18,400,000.00	10/1/92	13.573%	14.034% ann.
TENNESSEE VALLEY AUTHORITY					
Power Bond, Series 1981-E	12/4	650,000,000.00	12/31/11	13.035%	
Note #222	12/4	5,000,000.00	3/5/82	11.125%	
Note #223	12/11	70,000,000.00	3/5/82	10.997%	
Note #224	12/18	5,000,000.00	3/5/82	11.511%	
Note #226	12/31	30,000,000.00	3/5/82	12.166%	
Seven States Energy Corporation (TVA Guaranteed)					
Note A-82-03	12/31	343,877,651.62	3/31/82	12.166%	
DEPARTMENT OF TRANSPORTATION					
National Railroad Pasenger Corp. (Amtrak)					
Note #29	12/7	6,000,000.00	1/4/82	10.398%	
Note #29	12/28	3,000,000.00	1/4/82	11.647%	
Section 511					
Milwaukee Road 511-2	12/18	450,000.00	6/30/06	13.760%	
Chicago & North Western 511-1	12/28	55,626.00	3/1/89	14.118%	14.610% ann.
U.S. Railway Association					
Note #29	12/28	4,139,700.09	2/16/11	14.043%	

FEDERAL FINANCING BANK

December 1981 Commitments

BORROWER	AMOUNT	GUARANTOR	COMMITMENT EXPIRES	MATURITY
El Salvador 4	$16,500,000.00	DOD	12/5/83	12/5/93
Kenosha, Wisconsin	1,100,000.00	HUD	6/1/82	6/1/02
Philadelphia Authority for Industrial Development	10,000,000.00	HUD	10/1/82	10/1/02

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	December 31, 1981	November 30, 1981	Net Change 12/1/81-12/31/81	Net Change 10/1/81-12/31/81
On-Budget Agency Debt				
Tennesee Valley Authority	$11,390.0	$11,240.0	$150.0	$516.0
Export-Import Bank	12,741.3	12,409.3	332.0	332.0
NCUA-Central Liquidity Facility	90.2	92.6	-2.4	-11.1
Off-Budget Agency Debt				
U.S. Postal Service	1,288.0	1,288.0	-0-	-0-
U.S. Railway Association	202.4	200.1	2.3	-12.6
Agency Assets				
Farmers Home Administration	48,821.0	49,021.0	-200.0	-0-
DHHS-Health Maintenance Org.	119.0	118.5	.6	2.6
DHHS-Medical Facilities	150.5	150.5	-0-	-0-
Overseas Private Investment Corp.	24.3	26.6	-2.3	-2.3
Rural Electrification Admin.-CBO	2,595.3	2,595.3	-0-	-0-
Small Business Administration	64.9	65.6	-.8	-2.5
Government-Guaranteed Loans				
DOD-Foreign Military Sales	9,702.8	9,596.7	106.1	555.2
DEd.-Student Loan Marketing Assn.	4,600.0	4,600.0	-0-	300.0
DOE-Geothermal Loans	22.4	22.4	-0-	5.4
DOE-Hybrid Vehicles	2.2	2.2	-0-	0.1
DOE-Synthetic Fuels	39.9	29.3	10.7	39.9
DHUD-Community Dev. Block Grant	76.6	74.0	2.6	2.4
DHUD-New Communities	33.5	33.5	-0-	-0-
DHUD-Public Housing Notes	1,195.9	1,078.3	117.5	267.4
General Services Administration	412.0	412.6	-.7	-.7
DOI-Guam Power Authority	36.0	36.0	-0-	-0-
DOI-Virgin Islands	29.9	29.9	-0-	-0-
NASA-Space Communications Co.	683.1	651.7	31.4	45.4
Rural Electrification Admin.	13,516.3	12,923.8	592.9	1,173.7
SBA-Small Business Investment Cos.	624.3	613.7	10.5	20.4
SBA-State/Local Development Cos.	11.4	8.4	3.0	6.2
TVA-Seven States Energy Corp.	1,014.7	973.2	41.5	100.6
DOT-Amtrak	844.2	835.5	8.7	64.3
DOT-Emergency Rail Svcs. Act	70.2	70.2	-0-	-0-
DOT-Title V, RRRR Act	118.8	119.4	-.6	-4.8
DOT-WMATA	177.0	177.0	-0-	-0-
TOTALS*	110,697.9	109,495.3	1,203.1	3,397.7

*figures may not total due to rounding

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

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STATEMENT OF
THE HONORABLE STEPHEN J. ENTIN
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

Mr. Chairman and Members of the Subcommittee:

I should like to take this opportunity to present the views of the Treasury on H.J. Res. 365, which seeks to mandate a reconsideration of present economic policies, discouragement of so-called speculative lending, allocation of credit to selected uses, reconsideration of tentative money growth targets by the Federal Reserve, and appointments of members of the Board of Governors of the Federal Reserve System who are familiar with agricultural and commercial interests, including housing and small business.

The Administration shares the concerns of this Committee, and those of the Congress in general, about the problems associated with high interest rates. We are all well aware of the hardship that it imposes, particularly on those in certain sectors and groups within the economy. We do not agree, however, with the analysis and conclusion contained in House Resolution 365 as to the causes of, and therefore the remedies for, high interest rates.

Reconsideration of Policy

Section 1 of the Resolution declares that economic policies currently in place must be reconsidered to bring down interest rates.

Mr. Chairman, we reconsider our policies each day as we watch the financial markets, the inflow of economic statistics and tax receipts, and the outlay of funds. We have just undergone the major annual review of the economy in preparing for the President's budget message next week.

R-589

Each time we review the old and new economic evidence, it becomes clearer that our policies are on the right track; the old stop and go fiscal policies and erratic monetary policy we inherited from the past were directly responsible for rapid inflation, rising interest rates, a falling economy and a rising budget deficit.

Following the recovery from the 1974-1975 recession, real GNP growth declined steadily, from increases of 5.5 percent year over year in 1977, 4.8 percent in 1978, and 3.2 percent in 1979 to a decrease of 0.2 percent in 1980. Contrary to the conventional wisdom that slower growth would reduce inflation, inflation worsened. The CPI rose 6.5 percent year over year in 1977, 7.7 percent in 1978, 11.3 percent in 1979, and 13.5 percent in 1980.

With higher inflation came higher interest rates. After averaging just over 5 percent in 1977, the 3-month Treasury bill rate tripled to over 15.5 percent by December of 1980. The prime rate was 21.5 percent in December of 1980, having exceeded 13 percent in 12 of the previous 16 months.

Productivity, measured year over year, fell from 1977 to 1980. This was reflected in wages. Real average hourly earnings were lower in 1980 than in 1971! Meanwhile, tax burdens generally were substantially higher, reducing take-home pay per worker even further.

During this period of general decline, the government kept growing. Budget outlays rose from between 20 and 21 percent of GNP in the early 1970's to a postwar record of 23.1 percent in Fiscal Year 1981--nearly one dollar in every four generated by our economy. Outlays soared nearly 200 percent during the decade of the seventies.

The tax burden was rising as well. In spite of legislated tax reductions the overall tax receipts of the Federal government rose nearly $250 billion from FY 1977 to FY 1981 and still we accumulated deficits of almost $200 billion.

Inflation forced taxpayers into higher marginal tax brackets and created serious problems for work incentives, saving and investment. Personal savings rates fell from 8.6 percent of disposable income in 1975 to 5.6 percent in 1980, and bottomed out at a low 4.3 percent in the first quarter of 1981. In the labor markets, the rising marginal tax rates were impairing the competitive situation of U.S. labor in the world economy.

Businesses fared no better. Inflation increased their tax liabilities and distorted their saving and investment decisions due chiefly to the fact that depreciation allowances were not adjusted for the rising cost of plant and equipment in computing taxable income. The rate of return on plant and equipment plummeted, reducing investment and productivity growth sharply.

The economy in early 1980 had been weakened by four years of excessive money growth, rising inflation, rising interest rates, rising tax rates, and rising Federal spending as a share of GNP. Rates of return on investment and savings were severly depressed. The interest-sensitive sectors, such as autos and homebuilding, were already in a severe slump.

The second quarter of 1980 was one of sharp collapse, at a 9.9 percent annual rate. It was followed by two quarters of very slow recovery, with 2.4 and 3.8 percent growth. Not until the 8.6 percent growth of the first quarter of 1981 did real GNP exceed that of the first quarter of 1980.

Unfortunately, the 1981 recovery was soon choked off in what might best be described as a continuation of the 1980 situation. Homebuilding and autos had never really recovered from the slump of the previous year. The basic causes of the 1980 downturn had never really been corrected. The causes were the same: erratic money growth, continued high inflation and interest rates, and rising tax rates.

By the spring of 1981, autos, construction and consumer durables were under renewed pressure, responding to the renewed upturn in interest rates. Real GNP fell 1.6 percent at an annual rate in the second quarter, although it recovered a bit in the third, rising at a 1.4 percent annual rate, before declining at a 5.2 percent rate in the fourth quarter.

The National Bureau of Economic Research has picked July as the peak month of the expansion, although the economy was clearly not healthy for several months prior to that point. One could just as easily characterize 1980 and 1981 as a single period of zero growth or recession.

The erratic pattern of money growth that occurred in 1980 and in 1981 and which contributed to the onset of the current downturn. At various times during the year, we at Treasury have hinted, sometimes in private, sometimes in public, that we would like either faster or slower money growth. Some have accused us of being unable to make up our minds.

Nothing could be further from the truth. We have consistently urged faster money growth when the money supply was flat or declining, and slower money growth when the money supply was rising at double digit rates. We supported the Federal Reserve's targets, and consistently urged them to keep money growth even and steady within the target range.

In the last three months of 1980, M1B fell at an annual rate of one percent per year, after a sharp rise in the previous five months. Virtually all of the growth in M1B in 1981 occurred in the first four months of the year, when it grew at a 13.3 percent annual rate, and the last two months of the year, when M1B growth was at a 13.0 percent rate. In the interim, M1B oscillated from week to week. In the six months from April to October, the net change was a decrease of 0.1 percent. Such volatile money growth has very damaging effects on the economy. It destroys the credibility of long-run monetary controls, adds to uncertainty and risk, and thereby helps keep interest rates high as lenders seek to protect their principal.

This very erratic pattern has kept financial markets in a state of disarray for some time. During 1981, there appeared to be a particularly close relationship between variability in monetary growth and short-term rates. Acceleration in monetary growth was associated with sharp increases in short-term rates, while deceleration in monetary growth was associated with declines in short-term interest rates. This is an important lesson. Faster money growth causes interest rates to go up, not down.

The past three months provided a good example of the disruptive effects of volatile money growth. Since October the rate of money growth has accelerated rapidly, following six months of near-zero growth. The rapid reacceleration of money growth has renewed concerns about inflation, renewed skepticism about monetary control in general, and created enormous uncertainty in the financial markets. The result has been a reversal of the dramatic decline in interest rates that had been under way since September. I hope that those who still believe that high interest rates are caused by a "tight" monetary policy have been paying attention. A steady monetary policy is absolutely essential if we are to steady the financial markets and reduce interest rates. Stability of policy is the key requirement for any permanent recovery in output and employment.

This was the situation we inherited. Fortunately, we understand its causes, and have put into place a four-part program to correct the errors of the past, and to restore economic growth and full employment while reducing inflation.

- With the help of the Congress, we achieved significant reduction in the growth of Federal spending for Fiscal Years 1982 and beyond.

- An incentive tax policy is in place. The Economic Recovery Tax Act was signed into law in August 1981 with its major provisions taking effect over five calendar years.

  Under the full three-year incentive tax rate reduction, followed by indexing in 1985, bracket creep that has been poisoning labor negotiations and pricing U.S. labor out of world markets is at an end. The rising marginal tax rates that, with inflation, have cut personal savings rates in all brackets almost in half between 1975 and 1980, will be reduced.

  The accelerated cost recovery system will restore a reasonable rate of return on investment in plant and equipment. For the first time in years, firms will be allowed a tax write-off large enough to let them fully replace their plant and equipment, the costs of which have been rising sharply with inflation.

- Regulatory reform is under way to reduce the inefficiencies and enormous costs that are holding back production and raising prices.

- Monetary policy has shifted toward reducing inflation. We have encouraged the Federal Reserve to keep money growth steady at levels consistent with a gradual return to stable prices and low interest rates.

  We supported money growth in the middle of the Federal Reserve's M1B target range in 1981, which the Fed did not achieve on a fourth quarter to fourth quarter basis. We support money growth in the upper third of the Federal Reserve's tentative M1 target range for 1981, and hope for better success in reaching that rate.

The causes and the timing of the recession are obvious to any reasonable observer. The economy was peaking out and entering the recession months before the Administration's economic program was in place. The spending reductions and tax changes, both less than we had initially hoped for, were enacted in August after the recession began, and will have their major impact in Fiscal Year 1982 and beyond.

There is no school of economic thought--Keynesian, monetarist, or supply side--which provides even the hint of a suggestion that any of the policies called for by the Administration could have retroactively brought on this downturn. Indeed, spending restraint and tax incentives are widely recommended policies for encouraging growth and modernization of the private sector. Stability in monetary policy tends to reduce interest rates and inflationary expectations and is a necessary precondition for the saving and investment essential to growth. If fact, there is no other way to reduce interest rates on a permanent basis.

These policies are just beginning. It will take time for them to work. However, there are signs of progress already.

° Consumer prices, which rose 12.4 percent during 1980, rose 8.9 percent in 1981.

° Producer prices for finished goods, which rose 11.8 percent during 1980, rose only 7.0 percent in 1981, and indicate continued moderation at the consumer level in the months ahead.

° Interest rates, driven by inflation to record highs in the last two years, have since fallen. The prime rate, 21-1/2 percent a year ago, is now at 15.75.

° Manufacturers' durable goods orders, an important leading indicator, have shown broad-based increases in the last two months. Housing starts are up. These are signs that the economy may be heading up by the second quarter.

We must continue to restrain the growth of Federal spending to enable the economy to grow out from under the spending burden. Whether financed by taxes or borrowing, government spending absorbs physical and financial resources better used for private sector growth.

While selected tax changes may be desirable to eliminate outmoded provisions in the tax law, care must be taken to preserve the saving and growth incentives embodied in the Economic Recovery Tax Act.

The basic cause of the currently projected deficits is not the tax cut. The basic cause of the projected deficit is the sluggish economic performance of 1980-1981 and the continued rapid growth of government spending in real terms. For each additional point of unemployment, the deficit is widened by about $25 billion as revenues fall and outlays rise on income maintenance programs.

In spite of all the tax changes we have enacted, the $3 trillion U.S. economy, if it were growing at four to five percent per year in real terms, would generate $30 to $35 billion in additional real tax revenues each year in 1981 dollars. If spending were not still rising in real terms, that is how fast the deficit would be falling.

Spending reduction and economic growth are the only methods for balancing the budget while increasing employment, take-home pay and living standards. On the other hand, without spending restraint and faster real economic growth, it is doubtful that we will ever see a balanced budget.

I understand the concerns of Congress and the financial markets over the deficit. Deficits do matter.

However, we are confident that the saving of households and businesses over the next few years will be adequate to finance both the projected deficits of the total government sector and a very rapid increase in real capital formation. We will not need inflationary money growth to finance the deficits. With inflation down and savings up, interest rates will fall. It is amply clear from history, both here and abroad, that deficits, if not monetized, do not produce inflation, and, therefore, do not have a major influence on interest rates.

I know, too, that there has been concern over the apparent reluctance of business to plunge ahead with new investment. It is not surprising that some businessmen are holding back until they are certain it is safe to proceed.

Some investors are waiting for a drop in interest rates. Others have been made nervous by the repeated calls in certain quarters for inflationary money growth or drastic modifications in the business and personal tax incentives contained in the ERTA. This uncertainty is delaying the economic recovery. Those who have been burned repeatedly by frequent changes in government policy may be forgiven for wondering if Washington can ever stick to a program long enough to make it work.

The best thing we can do for the economy is to get behind the President's program and see it through.

Credit Allocation

Section 2 of the Resolution urges the allocation of credit away from so-called "speculative" uses to so-called productive uses in favored sectors.

This section is based entirely on a misconception, described earlier, as to the cause of high interest rates, a misapprehension of the nature of so-called speculation and the amount of credit devoted to it, and a lack of appreciation of the steps already under way to lower interest rates and encourage savings to provide for additional capital formation, also described above.

The only way I know to assure adequate and affordable credit for the various sectors of the economy is to (1) bring interest rates down and (2) take steps to increase the total supply of savings available to the economy.

We will not alleviate the credit problems of interest-sensitive sectors, such as housing, by increasing the rate of money creation. That would only drive interest rates higher, and would only further damage the interest-sensitive sectors that have been so hard hit by two and a half years of high interest rates.

Credit allocation programs do not lead to an increase in the total supply of credit. By definition, such programs <u>allocate</u> credit, and every dollar of credit allocated <u>to</u> one borrower is allocated away <u>from</u> another borrower. When the government presumes it can do better than the market in judging a "good" use of credit from a "bad" use, it generally ends up diverting credit from a project with a high rate of return, reflecting output valued highly by consumers, to a low rate of return, reflecting output less highly valued.

The best way to assure adequate resources for eager borrowers is to increase the total amount of saving. The saving incentives contained in the new tax bill, as well as the tax cut itself, are designed to increase the total supply of savings available for borrowers to use. In addition, the best thing we can do is to remove the major disincentive to save that has been at work in the past decade: inflation.

As for speculative lending being a problem, there is no evidence of any such thing. I am submitting for the record a report on lending for merger activity. Funds provided recently for such purposes involve an amount of total credit which has not changed significantly from previous years. Furthermore, money lent to the purchaser is simply transferred to the sellers of the acquired firms. The money is changing hands; it is not destroyed; the money supply is not affected in any meaningful way. "Speculation" in commodities and real estate, in the sense of using real assets as an inflation hedge, is actually on the decline, as lower inflation raises the rate of return on financial assets relative to real assets. I am sure that the sponsors of the Resolution did not mean to include ordinary hedging, or the normal speculation which provides liquidity, stabilizes prices, and insures the proper functioning of the vitally important commodities markets in the perjorative term "unproductive" in Section 2.

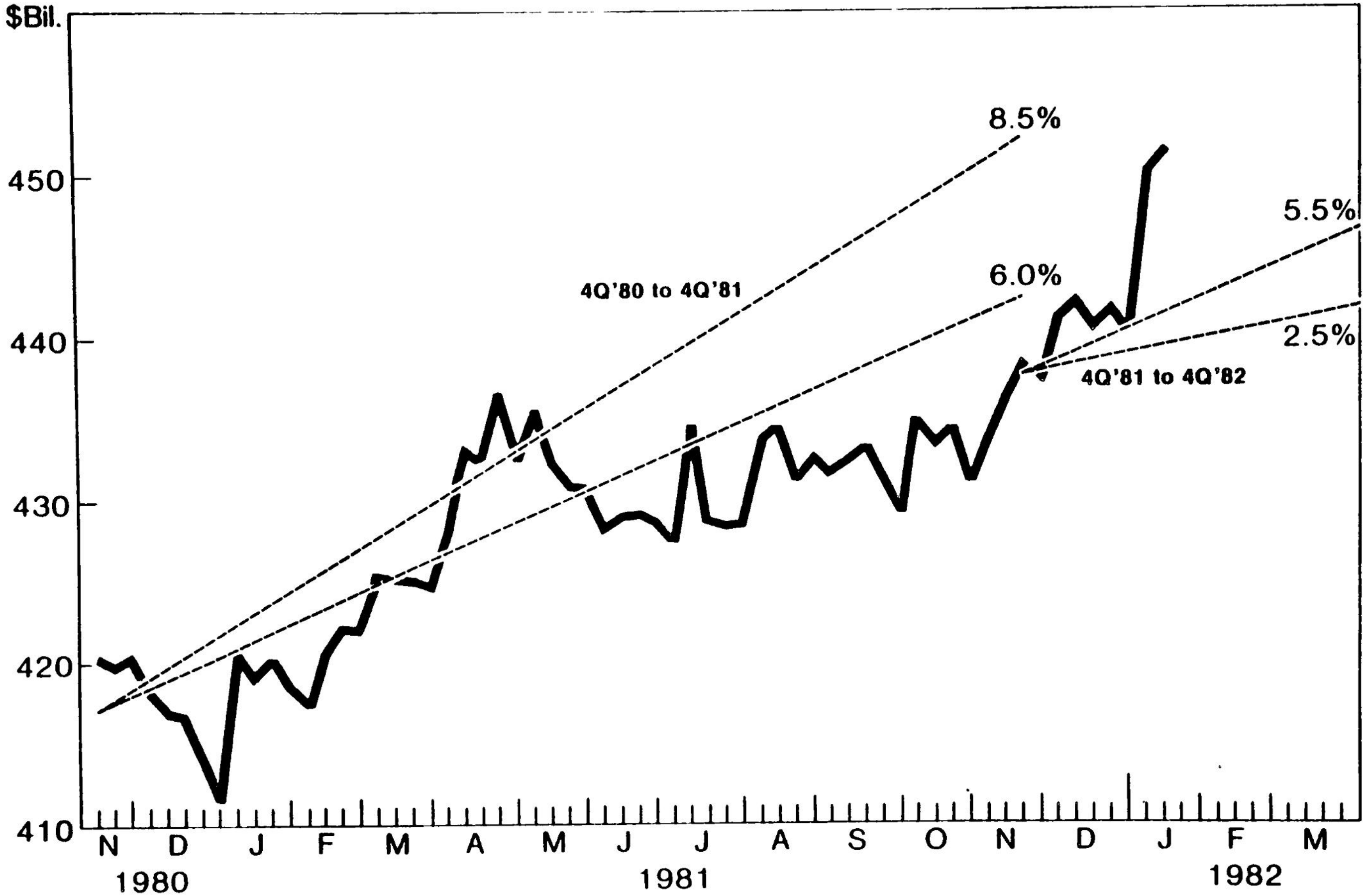
Fed Targets

Section 3 of the Resolution urges the Federal Reserve not to lower its monetary target range. The Fed's target range is less important than its actual performance. The Administration would like to see steady money growth in the upper third of the Fed's tentative M1 target range--between 4 1/2 and 5 1/2 percent for 1982. Furthermore, we would like to see money growth remain between these rates on a quarterly basis, not just end up there in a sudden dash at the end of the year. This would permit roughly the same average money growth as last year, just under 5 percent fourth quarter over fourth quarter, but would avoid a repetition of the excessive volatility of money growth of 1980 and 1981, which disrupted the financial markets and contributed to high interest rates. At the same time, a slightly reduced top end of the target range, from 6 percent to 5 1/2, is in conformity with the Fed's intention gradually to reduce the growth of money to non-inflationary levels over the long term.

Representation on the Federal Reserve Board

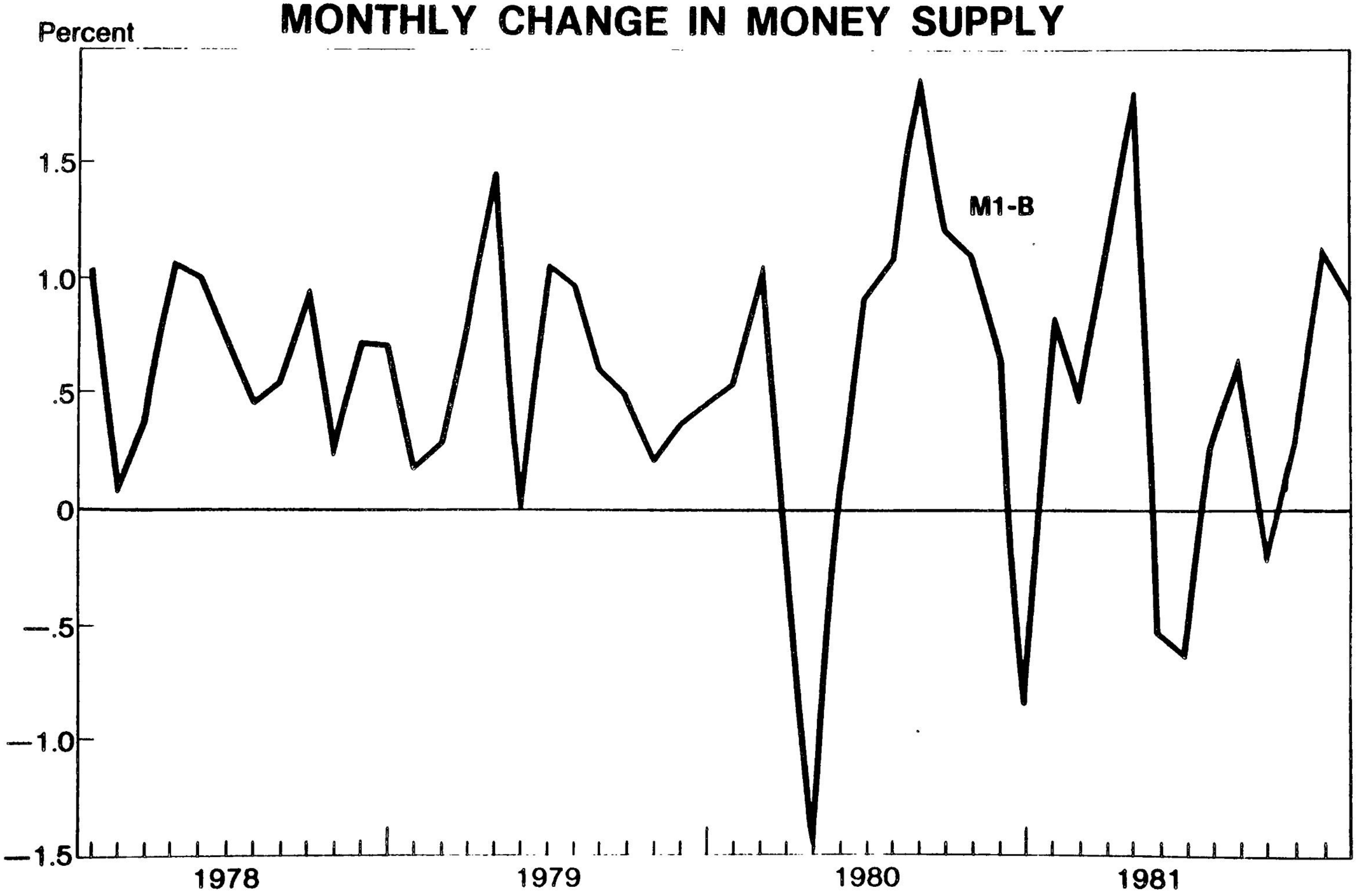
Section 4 of the Resolution implies that the Governors of the Federal Reserve Board are not representative of the various sectors and regions of the nation. The President has recently nominated Mr. Preston Martin of California to the Board. Mr. Martin has been an active participant in the savings and loan and housing industries for much of his professional life. This first appointment by President Reagan to the Board is a clear indication that this section of the Resolution is not necessary.

M1 VERSUS TARGET RANGE*



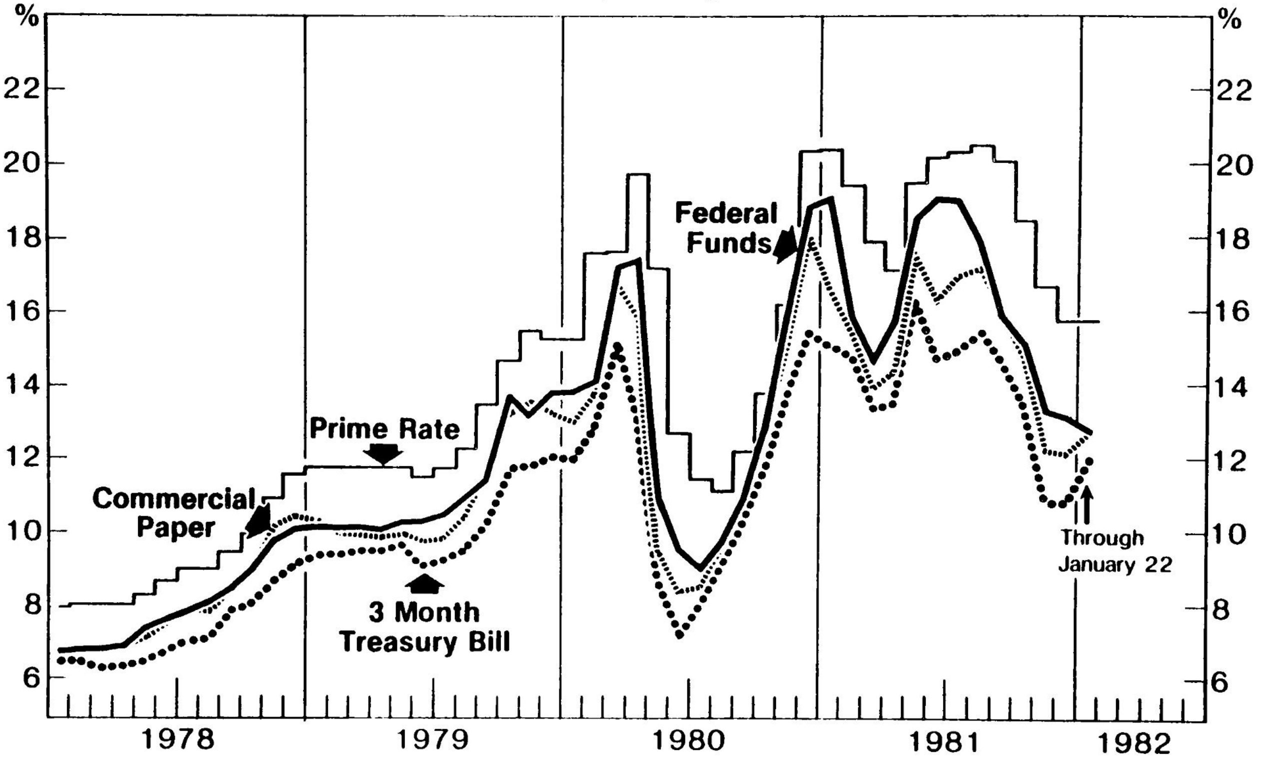
*Weekly Averages - Seasonally Adjusted

MONTHLY CHANGE IN MONEY SUPPLY



SHORT TERM INTEREST RATES

Monthly Averages

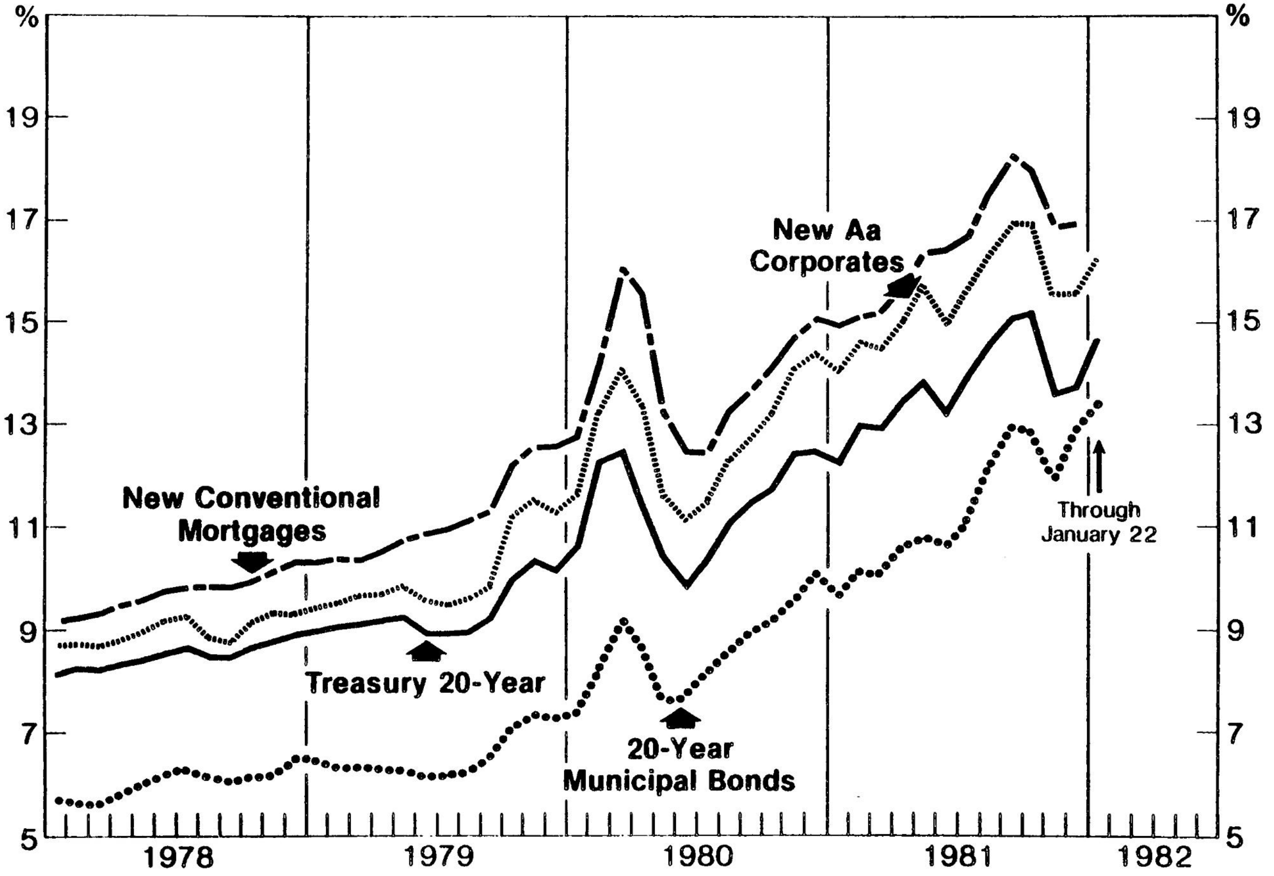


Office of the Secretary of the Treasury
Office of Government Financing

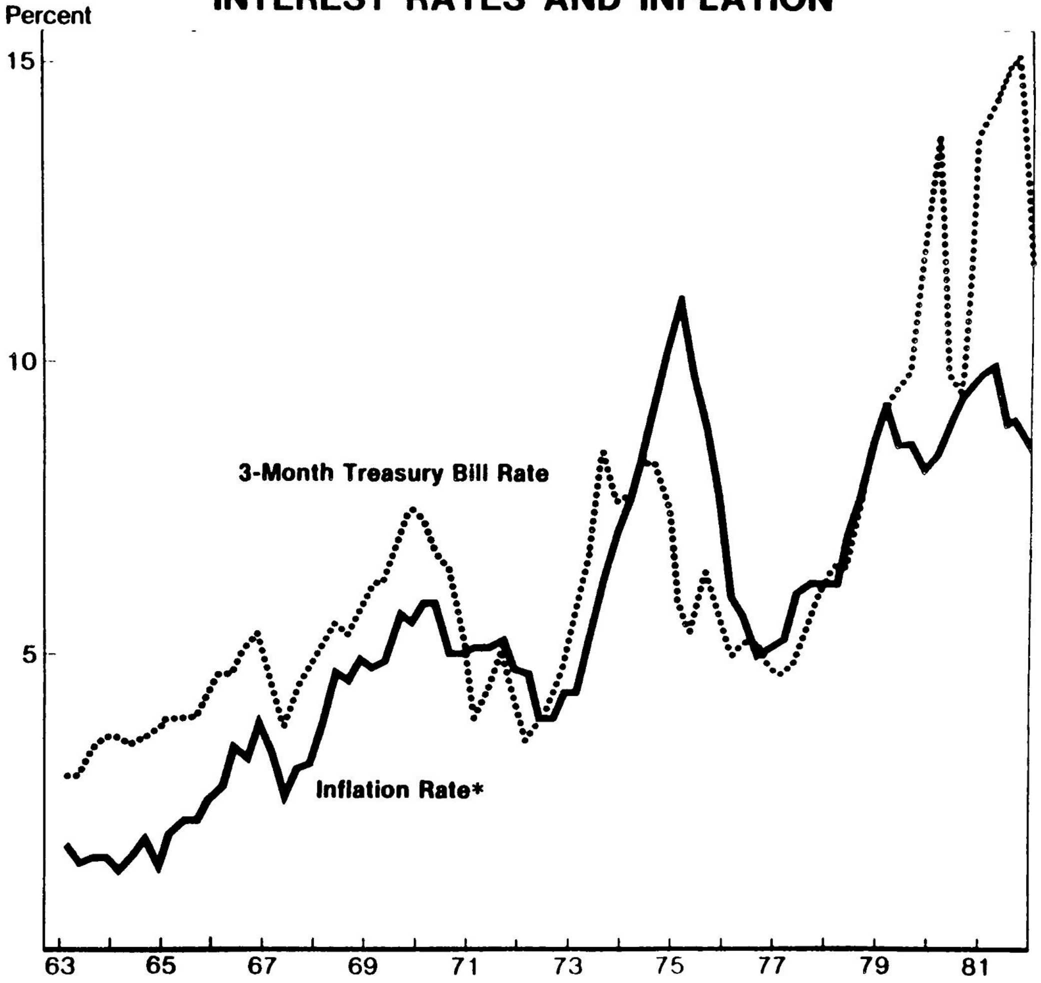
January 26, 1982-6

LONG MARKET RATES

Monthly Averages

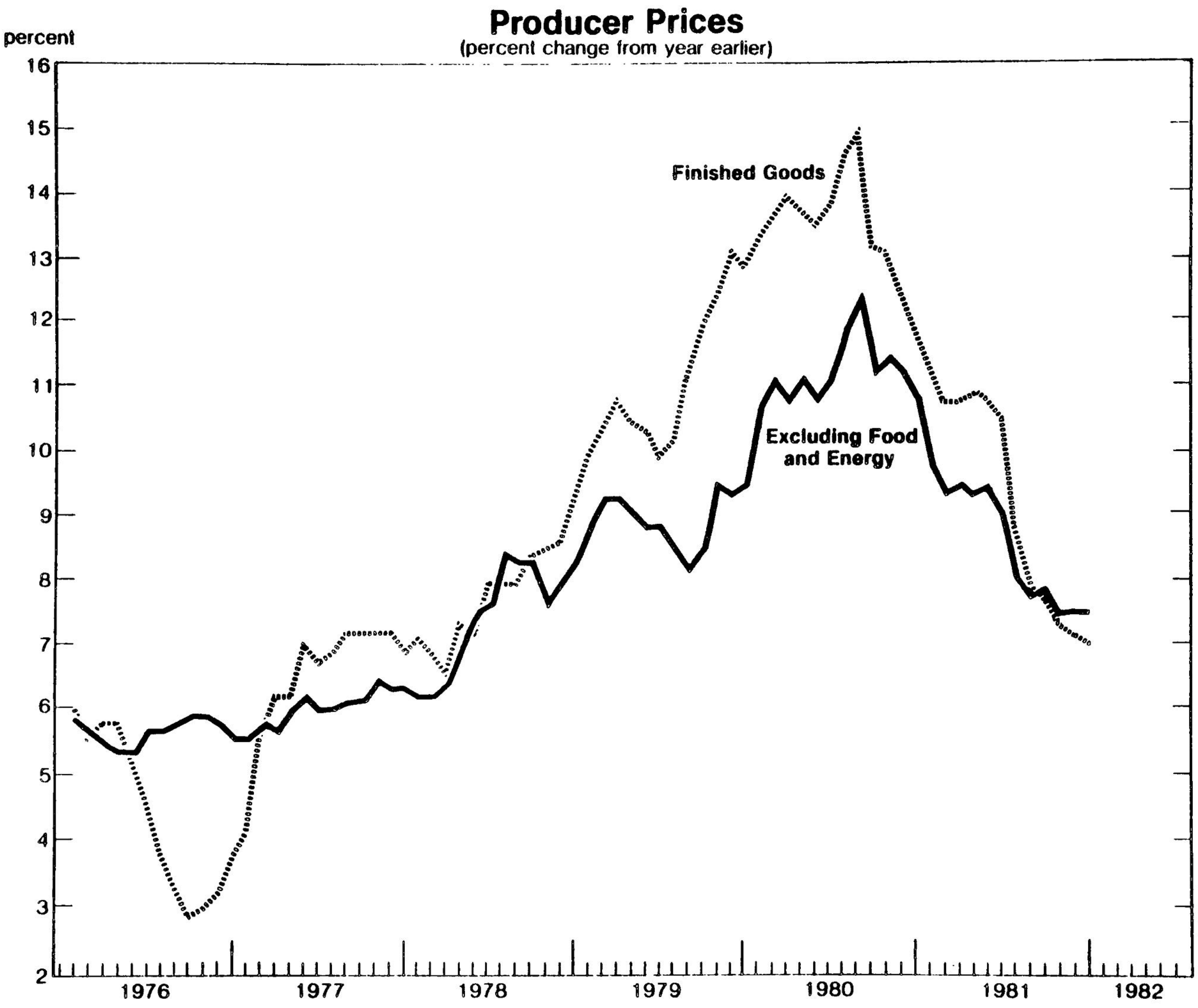


INTEREST RATES AND INFLATION



* Growth from year earlier in GNP deflator.
Plotted quarterly.

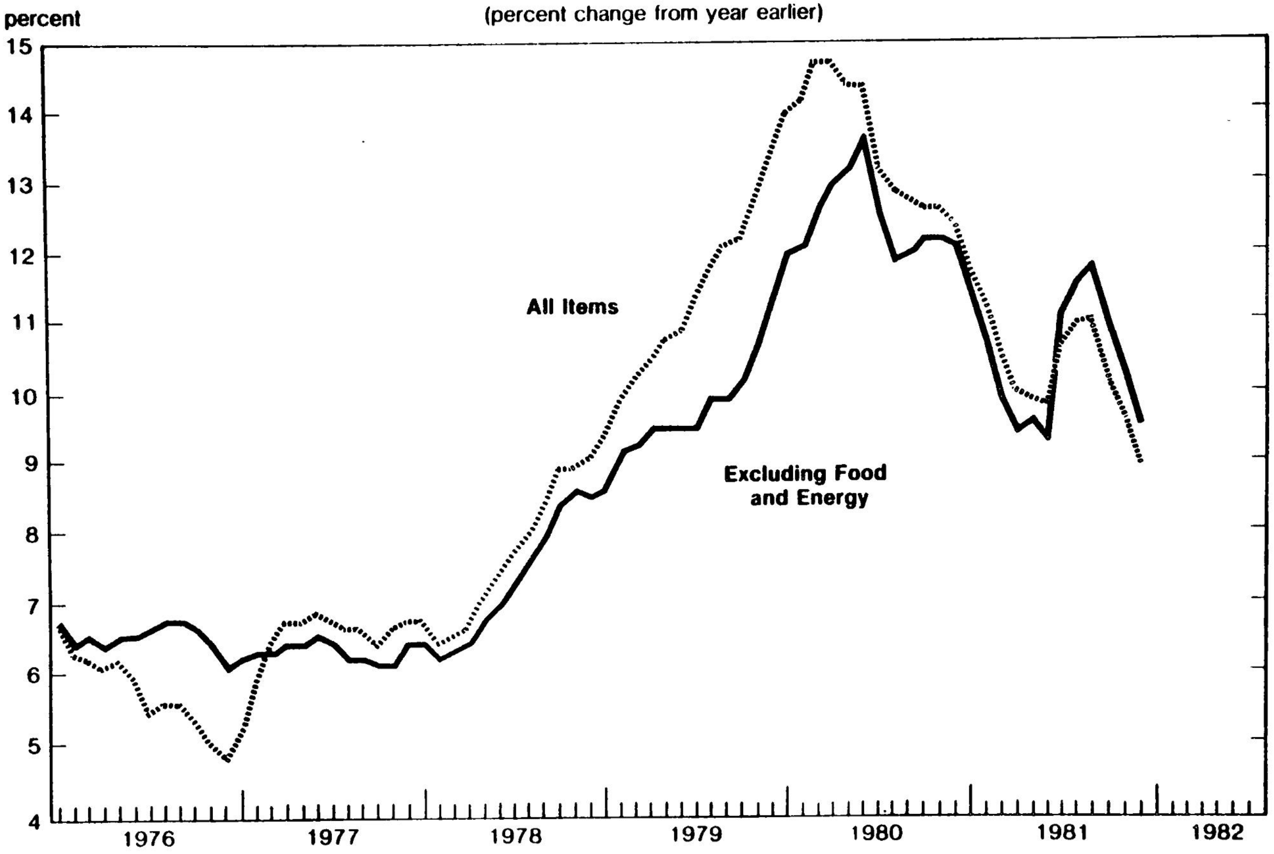
January 27, 1982 A158



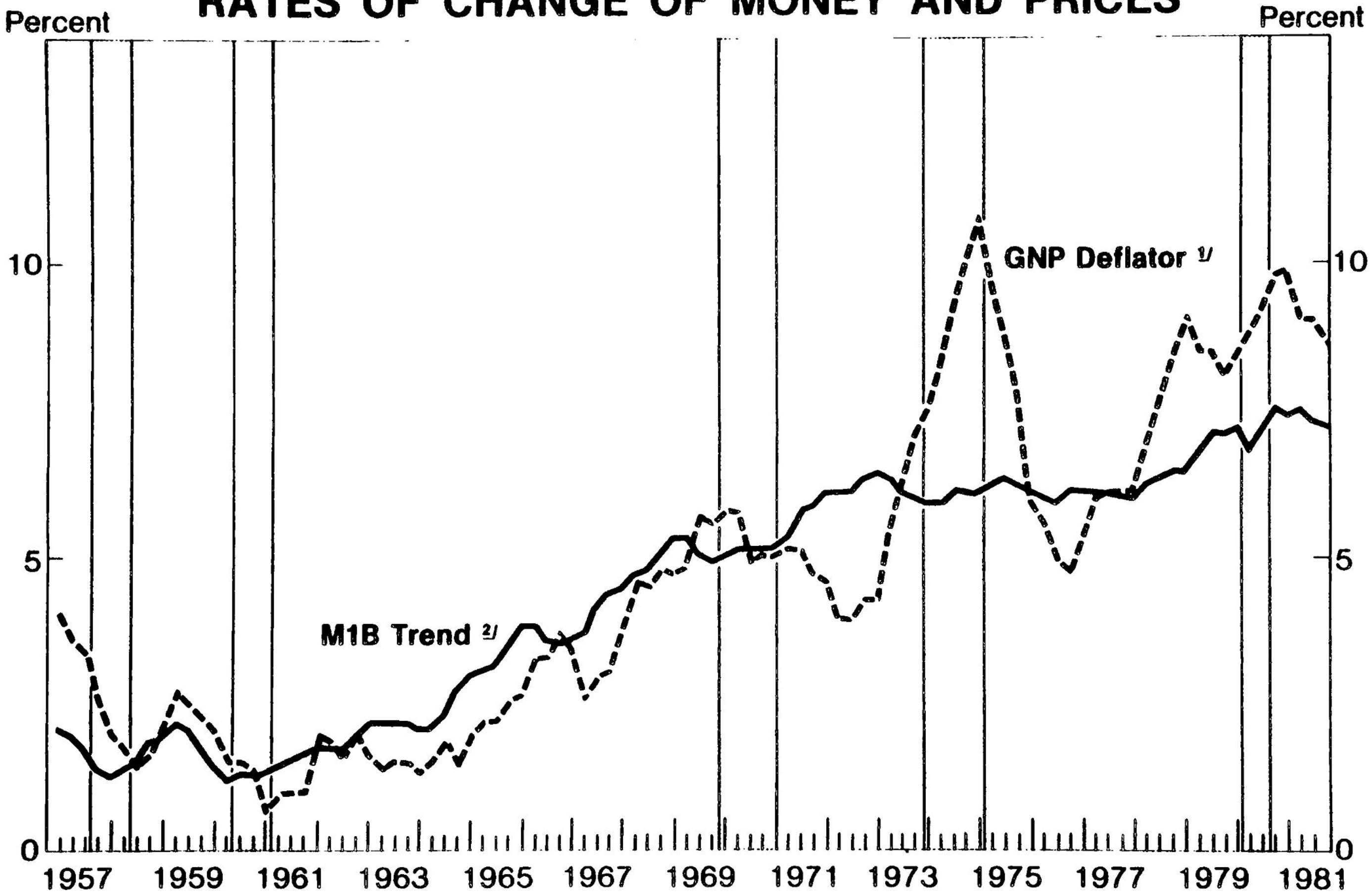
Producer Prices
(percent change from year earlier)
percent
16
15
14
13
12
11
10
9
8
7
6
5
4
3
2
Finished Goods
Excluding Food
and Energy
1976
1977
1978
1979
1980
1981
1982

Consumer Prices

(percent change from year earlier)



RATES OF CHANGE OF MONEY AND PRICES



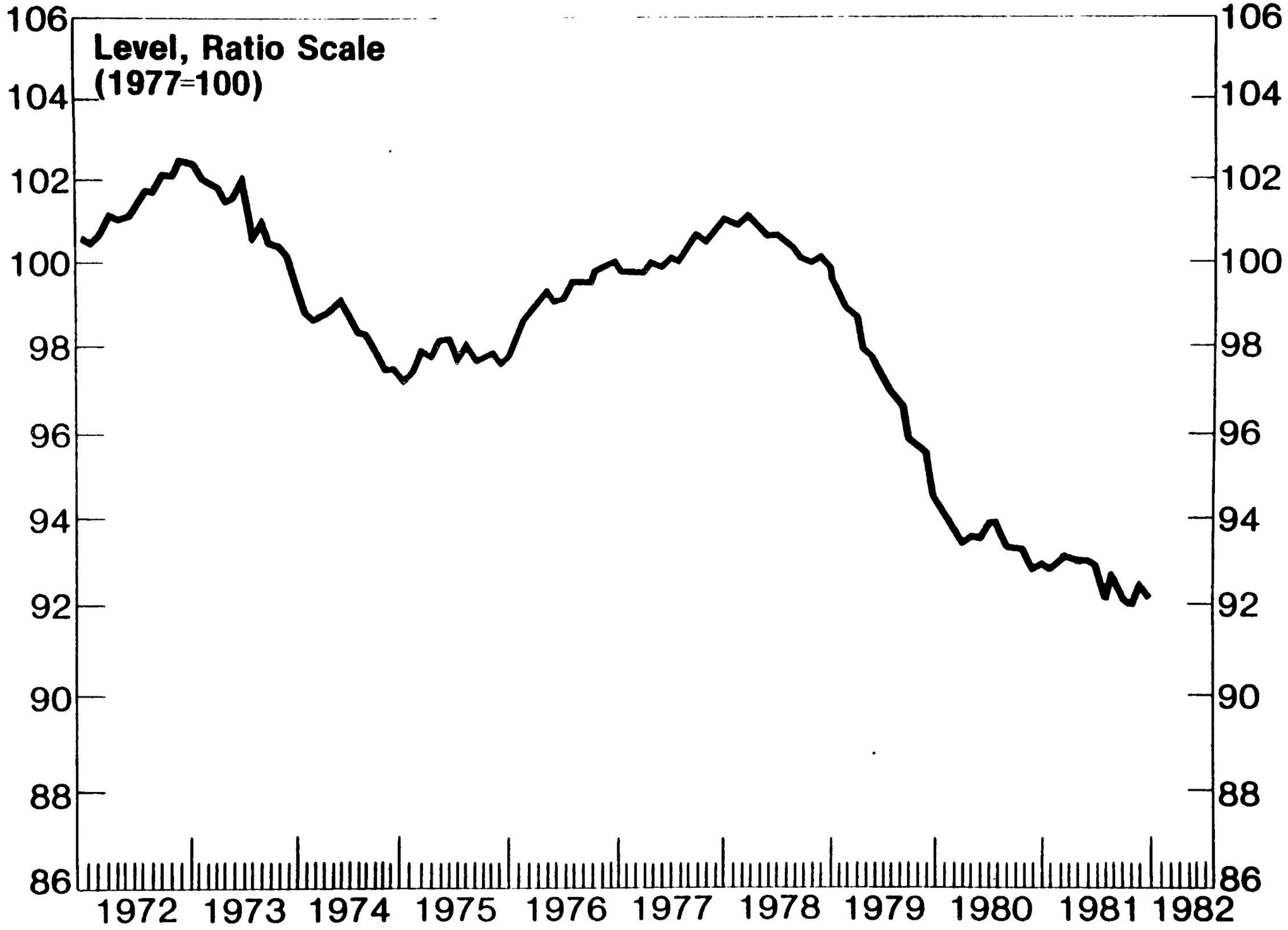
1/ Four-quarter rate of change;

2/ Twenty-quarter rate of change; data prior to 1st quarter 1964 are M1.

Latest data plotted: 4th quarter

January 27, 1982-A164

Real Average Hourly Earnings Index
Total Private Nonfarm Economy, 1977 Dollars



Merger Activity and Bank Credit

This report was prepared in response to a request to Secretary Regan by Chairman Domenici of the Senate Committee on the Budget to provide a historic perspective on the amounts of money involved in merger activity. 1/ It provides measures of merger activity for 1981 and for previous years and documents the growing use of cash in these transactions. The impact of the use of bank credit for merger purposes is briefly analyzed.

1981 Merger Activity

Corporate mergers and acquisitions increased both in their size and in number during the first three quarters of 1981, according to data reported by W.T. Grimm & Co. 2/ There were 1,807 merger announcements during this period compared with a total of 1,889 announcements for all of 1980. Total reported payments associated with these mergers in the first nine months of 1981 amounted to $60.8 billion--about double the amount for the comparable period the year before. The total for all of 1980 was $44.3 billion.

There has also been increased activity this year with respect to large merger deals. Ninety-four of the mergers in 1981 had a reported purchase price in excess of $100 million. This is the same number that occurred during the entire previous year. In 1980 four of these transactions involved payments in excess of $1 billion. Together, the four were valued at $8.4 billion. After nine months the 1981 count of billion dollar mergers stood at eight. These eight contributed $24.3 billion or nearly 40 percent of the overall dollar total for the first nine months.

Mergers and takeovers are obviously not new phenomena, and it is doubtful whether current rates of corporate acquisition approach those of the period 1967 to 1969 in relative terms. In particular the data on merger activity are biased upward. The dollar amounts of mergers and the assets involved should be

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1/ This request was made during a Committee hearing held on October 30, 1981.

2/ W.T. Grimm & Co. collects data on net merger and acquisition announcements, defined as "completed or pending transactions as of the end of the applicable period. Grimm records publicly announced transfers of ownership of at least 10 percent of a company's assets or equity. Divisional or partial sales must have a minimum purchase price of $500,000 to be included in the merger count." W.T. Grimm & Co., 1980 Merger Summary. Data for 1981 was obtained from an October 21, 1981 news release, "Merger Upturn Persists, Third Quarter Up 25%."

adjusted to remove the effects of inflation, which account for some of the rise in merger activity over time. Also, growth of the economy would normally be expected to increase the number of firms and, hence, the trend of mergers. What is new, however, is the dramatic increase in the use of cash, rather than stock swaps, in the financing of mergers. Furthermore, at least with respect to tender offers, 3/ bank credit has apparently been an important direct source of that cash.

Historical Perspective

Table 1 reports merger announcements for the years 1973-1981. These data show a relatively high level of mergers in 1973. The number of announcements falls precipitously through 1974 and 1975 and more slowly thereafter, with a small upturn in 1979 and a more noticeable upturn in 1981. However, the data on larger mergers (in excess of $100 million) illustrate an almost exact opposite trend, increasing continuously since 1975. The number of these large merger announcements nearly tripled in 1976, almost doubled again in 1978, and are rising very rapidly in 1981. The number of mergers with payments in excess of $500 million almost tripled in 1979.

Table 2 shows the type of announcements being recorded. In recent years, about 35 percent of the announcements each year have involved a divestiture. 4/ Over 50 percent of the announcements involve the merger of closely held companies. This latter type of merger typically involves less use of cash, with a greater reliance on stock swaps. Mergers of publicly traded companies constitute roughly 10 percent of merger activity each year. Of these, less than a third are tender offers. Thus, tender offers, which account for most of the takeover headlines, represent less than four percent of total mergers.

3/ A tender offer is one means of attempted corporate acquisition by which an effort is made to purchase a controlling or majority interest in a publicly held stock, often bypassing the target firm's management.

4/ Divestitures are defined as "partial sales where 10 percent or more of a company's equity is purchased as well as divisional sales where a product line, subsidiary, or a diversion is sold." W.T. Grimm & Co., 1980 Merger Summary.

Table 1

Merger and Acquisition Announcements

Year	Number of Announcements: Total	With purchase price in excess of $100 million	With purchase price in excess of $500 million	Total Reported Payments** ($billion)
1973	4,040	n.a.	n.a.	n.a.
1974	2,861	n.a.	n.a.	n.a.
1975	2,297	14	1	11.8
1976	2,276	39	4	20.0
1977	2,224	41	2	21.9
1978	2,106	80	5	34.2
1979	2,128	83	14	43.5
1980	1,889	94	15	44.3
1981*	2,409	125	16	81.7

*Annualized numbers based on 1,809 mergers during the first nine months of the year.

**These figures should be treated with caution. A minority of total transactions typically report dollar amounts. For example, in 1979, payments data were available for 1,047 mergers, or 49 percent of the total number of transactions. In 1980, payment data were available for 47 percent of the transactions.

n.a. - Not available from sources cited.

Source: W.T. Grimm & Co., various news releases and <u>Merger Summary</u>, 1977, 1980.

Table 2

<u>Merger Type</u>

(Pércent of total announcements.*)

Year	Divestiture	Privately-held Companies	Publicly Traded Companies Total	Publicly Traded Companies Tender Offers
1976	46	38	7	2.2
1977	45	44	9	2.6
1978	39	46	12	3.4
1979	35	49	12	3.7
1980	35	52	9	2.1
1981**	34	56	n.a.	n.a.

* A residual category not shown here includes foreign sellers.

**Percentages reflect nine months activity.

n.a. - Not available from sources cited.

Source: W.T. Grimm & Co., various news releases and <u>Merger Summary</u>, 1977, 1980.

W.T. Grimm & Co. reports that 30 percent of total announced tender offers in 1979 (as distinguished from completed or pending offers) involved bids of $75 million or more. The equivalent figure for 1980 was 35 percent. This percentage has increased dramatically since 1975 when only 7 percent of the offers were in this range. 5/ This increase is due partly to a general inflation of asset prices over the years and partly to a real move towards relatively larger takeover bids. 6/

A longer term perspective on merger and acquisition activity may be obtained from data collected by the Bureau of Economics of the Federal Trade Commission (FTC). Two series have been compiled by that agency: an overall merger series, and a large merger series that includes acquired manufacturing and mining companies with assets of $10 million or more. Data pertaining to these mergers are shown in Table 3. Unfortunately, the FTC data collection effort was discontinued after 1979 so that comparable numbers for the most recent years are not available. Also, the FTC coverage of mergers is more limited conceptually than the data reported in Table 1. 7/ The two series, therefore, are not comparable.

5/ W.T. Grimm & Co., Merger Summary, 1976, 1977, 1980.

6/ These data are not good measures of the relative growth in merger activity, as they contain an upward bias over time. First, with economic growth, the number of firms in the economy will grow and there is no reason why the number of mergers should not expand accordingly. Similarly, new economic growth, as well as inflation, should support an upward trend in asset values over time.

7/ To be included in the FTC data, an acquisition must meet four criteria:

1. The FTC must have jurisdiction over the industry to which the acquired company belongs. This excludes commercial banks, transportation entities such as railroads and airlines, and communication concerns such as radio and television stations.

2. The acquiring concern must acquire at least 10 percent of the acquired company's stock or assets.

3. The acquired company must be American.

4. The acquired company must be an independent company, a subsidiary or division of another company, or a division of a subsidiary.

Bureau of Economics, Federal Trade Commission, Statistical Report on Mergers and Acquisitions, 1979, p. 11. Whereas W.T. Grimm reports dollar figures for payments (for about half its announcements), the FTC records dollar figures for assets of large mergers only. The latter also records "compensation paid" when publicly available for large mergers.

Table 3

FTC Merger Series

Year	Overall Merger Series: Number Completed*	Large Manufacturing and Mining Acquisitions: Number**	Total Assets of Acquired Firms ($millions)	Assets as a Percentage of all Manufacturing and Mining Corporations
1948		4	114.4	0.10
1949		6	89.0	0.08
1950		5	186.3	0.15
1951		9	201.5	0.14
1952		16	385.3	0.22
1953		23	795.1	0.44
1954		37	1,479.0	0.81
1955		67	2,227.3	1.17
1956		53	2,110.5	1.00
1957		47	1,427.7	0.62
1958		42	1,173.1	0.50
1959		49	1,712.2	0.69
1960		51	1,734.1	0.65
1961		46	2,234.9	0.81
1962		65	2,660.7	0.91
1963		54	3,187.1	1.04
1964		73	2,576.5	0.80
1965		64	3,721.9	1.07
1966		76	4,380.2	1.13
1967		138	8,955.7	2.10
1968		174	13,759.2	2.94
1969		138	12,219.2	2.32
1970		91	6,601.1	1.14
1971		59	3,140.5	0.51
1972	2839	60	2,670.8	0.41
1973	2359	64	3,558.8	0.50
1974	1474	62	5,118.9	0.69
1975	1047	59	5,528.0	0.70
1976	1164	82	6,926.0	0.80
1977	1207	101	10,129.5	1.08
1978	1279	111	11,770.4	1.14
1979***	1214	97	16,033.6	1.36

* Partial acquisitions are not included in this total.

** Data on number of acquisitions exclude companies for which data were not publicly available. There were 589 such companies with assets of $16,950.6 million for the period 1949-1979. These assets are included in the data reported here.

*** Figures are preliminary.

Source: Bureau of Economics, Federal Trade Commission. Statistical Report on Mergers and Acquisitions, 1979. Tables 10, 15, and 16.

The final column in Table 3 reports assets of acquired manufacturing and mining firms as a percentage of assets of all manufacturing and mining corporations. This series provides a good picture of relative aggregate merger behavior over time. These data show peaks of merger activity in 1955 and 1968 and indicate that merger activity had increased from a low in 1972 to a possible peak in 1979. The W.T. Grimm data discussed earlier imply that it is likely this current series, if it had been continued, would have shown a possible dip in 1980 (due to credit controls and the recession?) with a further upturn in 1981. It is unlikely, however, that 1981 data would have approached the levels of merger activity as had occurred in the boom years of 1967 to 1969.

In 1967 to 1969, over 80 percent of the reported compensation paid for acquired manufacturing and mining companies is estimated to have been in the form of stock shares. The data in Table 4 show that this percentage has dropped precipitously to where in recent years typically over 60 percent of the compensation is paid as cash and much of the rest is in some combination of cash and stock.

Using these data, two indexes of cash merger activity have been constructed. The first is obtained by multiplying the percentage of total manufacturing and mining assets acquired by the percent of reported compensation which is purely cash. This is the "cash only" index shown in Table 4. The second index is similarly obtained, using the percent of reported compensation that is either cash or a combination of cash and stock. This index is the "cash involved" index.

These indexes show vividly the increasing importance of cash merger transactions. In the relative merger index of Table 3 (column 4), the most recent year, 1979, registers less than half the (relative) merger activity as does the peak year 1968. However, in terms of the use of cash transactions, the 1968 activity is one-third that of 1979. This indicates that the potential impact of merger activity on credit market measures has increased from historical levels.

Tender Offers

Cash has been the predominant form of payment for tender offers, especially during the seventies. Over ninety percent of the offers from 1972 to 1980 have been cash offers. 8/ The use of cash, however, need not imply the use of bank credit. Firms often utilize internal financing sources. To investigate this relationship, the Securities and Exchange Commission collected for the years 1979 and 1980 information on the source

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8/ Douglas V. Austin, "Tender Offer Update: 1978-1979", Mergers and Acquisitions, Summer 1980, pp. 13-32.

Table 4

Compensation Paid and Cash Merger Activity

FTC Large Merger File*

Year	Total Compensation Paid ($ millions)	Cash (Percent)	Cash & Stock Combination (Percent)	Cash** Involved (Percent)	Indexes of Cash Merger Activity	
					Cash only#	Cash involved##
1967	2,955.3	3.1	2.7	5.8	.065	.122
1968	11,894.7	10.8	5.5	16.3	.317	.479
1969	5,390.3	8.2	7.2	15.4	.190	.357
1970	3,282.0	28.6	7.5	36.1	.326	.412
1971	1,611.6	25.8	6.3	32.1	.132	.164
1972	2,070.0	21.8	5.6	27.4	.089	.112
1973	2,073.3	22.6	2.2	24.8	.113	.124
1974	3,324.2	60.8	5.5	66.3	.420	.457
1975	2,826.8	59.4	13.7	73.1	.416	.512
1976	3,530.1	64.3	6.8	71.1	.514	.569
1977	5,637.8	39.1	14.9	54.0	.422	.583
1978	7.792.8	75.2	8.8	84.0	.857	.958
1979	7,796.3	65.6	32.9	98.5	.892	1.340

* Percentages are of asset totals, excluding acquisitions for which no public data were available.

** Sum of previous two columns.

\# Column "Cash", this Table, multipled by final column, Table 3.

\## Column "Cash Involved", this Table, multiplied by final column, Table 3.

Source: Constructed from Table 27, FTC Statistical Report, 1979. Data coverage of firms and assets is quite uneven from year to year.

of funds used in successful takeover bids. Table 5 shows the results as compiled by the Congressional Research Service. In 1979, more than half of the acquiring firms resorted to some form of bank credit to finance their takeovers and nearly three-fourths of the required funds were directly bank financed. Less than four percent of the takeovers used an exchange of shares. Most of the remainder resorted to internal financing. Whether this meant a bank loan had to be resorted to for some other reason is unknown. In any case, the data show a high reliance on bank participation for financing tender offers in 1979.

The 1980 experience was somewhat different. Less than 20 percent of the estimated cost was directly bank financed, and two-thirds were financed internally. This situation primarily reflects the impact of credit controls in that year.

To some extent, an emphasis on bank credit financing may reflect depressed stock prices. If stock prices are depressed, as has been the case in recent years, takeovers become an attractive proposition. An acquiring firm will generally use bank credit to finance the takeover if the price of its own stock is depressed. However, as the economy recovers and stock prices firm up, stock swaps should revive as a means of financing takeovers.

1981 Credit Activity

Only a portion of the known merger-related loan commitments contracted in 1981 have been taken down. For example, in one six-week period in 1981, nearly $40 billion in lines of credit had been announced in connection with nonfinancial corporate mergers of U.S. firms. 9/ U.S. banks and their overseas branches were responsible for an estimated $20 to $25 billion of these commitments. Through August, however, loan drawdowns at U.S. banks associated with these merger-related commitments amounted to approximately $5.2 billion. 10/

9/ Federal Reserve Bank of New York, Quarterly Review, Autumn 1981, p. 29.

10/ Perhaps another $1.5 billion was booked at foreign branches of U.S. banks (and, as such, is not included in the usual bank credit statistics). Unpublished estimates, Banking Section, Division of Research and Statistics, Board of Governors of the Federal Reserve.

Table 5

Source of Funds Used in Successful Takeover Bids

	1979 Number of Takeovers	1979 Total Estimated Cost ($millions)	1980 Number of Takeovers	1980 Total Estimated Cost ($millions)
Total Bank Participation	44	4,009.32 c/	26	758.02 a/
Unsecured bank loans	14	2,187.03 b/	7	145.36
Unsecured bank loans plus internal financing	23	1,447.99 a/	12	506.80
Secured bank loans	7	374.30	7	105.86 a/
Internal financing only	33	1,239.42 c/	27	3,259.12 b/
100 percent in exchange of shares	3	692.80	5	352.23 b/
External, non-bank financing	1	35.00	0	0.00
Source of funds not available	3	c/	4	312.00 b/
Total	81	5,283.74 e/	57	4,329.14 d/

a/ Excludes one takeover with no cost estimate.
b/ Excludes two takeovers with no cost estimate.
c/ Excludes three takeovers with no cost estimate.
d/ Excludes five takeovers with no cost estimate.
e/ Excludes nine takeovers with no cost estimate.

Source: Compiled by CRS from information provided by the SEC.

By way of comparison, total commercial bank loans and investments outstanding in August 1981 amounted to $1.3 trillion of which nearly $350 billion were domestic commercial and industrial (C&I) loans. Between December 1980 and September 1981 there was a net change of $25 billion in these loans. The $5.2 billion figure, therefore, represents 20.8 percent of the loans made during that period. This figure is biased upward, since it assumes that none of the merger loan money obtained was repaid during the period. Nevertheless, it appears that the merger related loans were a significant, but not overbearing, component of new domestic C&I credit extensions.

Impact of Bank Credit

An informal survey of banks indicated that U.S. banks did not expect to limit credit to other customers and would fund any loan drawdowns through issues of certificates of deposit (CDs), federal funds/repurchase agreements (REPOs), or Eurodollar borrowings. 11/ This indicates that the formation of loan commitments themselves does not have an appreciable impact on bank credit behavior. The bank consortia involved have ready access to worldwide money markets, and it is likely they finance any major drawdown, in the first instance, by increasing liabilities rather than by selling assets such as Treasury bills. 12/

The impact of an actual extension of bank credit which is used to purchase stock will depend on the disposition of the sale proceeds by the former stockholders. There is a good presumption that a very high percentage of the proceeds would be reinvested. 13/ It is possible, of course, that the former stockholders would choose to purchase the very same bank liabilities used to finance the merger loan. In this case, the funds would be completely recycled with a minimum impact on interest rates for CDs, REPOs, and other money market obligations.

11/ Information obtained from Banking Section, Division of Research and Statistics, Board of Governors of the Federal Reserve Board.

12/ Banks typically face an exogenous loan demand in the short run, accepting all legitimate loan applications meeting a specified risk criterion. The loan rate may vary with the perceived riskiness of the loan, but the rate structure itself changes with the cost of bank liabilities. It is very unlikely that a drawdown of a loan commitment will lead directly to a cancellation of another loan.

13/ With institutional sellers, this percentage is likely to approach 100 percent.

Theoretically, however, there may be some small impact on bank reserves and interest rates if such credits rise substantially above normal levels. An increase in Eurodollar borrowings and nonpersonal time deposits would cause a small increase in required bank reserves. This would put upward pressure on the federal funds rate and other short-term rates. These interest rates would have to rise to levels sufficient to induce (1) a shift from demand deposits and other checkable deposits (which carry higher reserve requirements) into bank nondeposit liabilities; (2) a sale of bank-held assets (Treasury bills) that eliminates bank liabilities and their attendant required reserves; (3) a shift into nonbank REPOs, which do not carry reserve requirements; and/or (4) induce banks to increase their borrowings from the Federal Reserve, adding to the supply of available reserves. 14/ However, if loan drawdowns to finance corporate mergers vary between $3-6 billion per year, this would involve a relatively small proportion, i.e., approximately 1-2%, of total bank reserves. Requirements of this magnitude are in line with those of recent years, and should not be a major new influence on the financial system or on the level of interest rates.

The impact on the money aggregates will depend upon the size of the lending, the use to which the public puts the stock sale proceeds, and the response of the Federal Reserve. In many cases the amount of the money supply will not change because the funds loaned will be recycled within the banking system, although probably not in the same financial institutions or even in the same financial form. Any effects on M1B, therefore, are likely to be only transitory. To the extent that short-term interest rates rise, there will be an inducement for the public to shift out of M1B assets into M2 and M3 assets. In addition, to the extent banks reduce their holdings of Treasury securities, the initial impact on M3 will be ameliorated. Also, where banks utilize Eurodollar borrowings rather than CDs, the impact on M3 will be lessened.

Conclusion

The level of credit extended by domestic U.S. banks for merger related purposes is small when compared to overall bank loan and investment activity. Furthermore, the fact that the

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14/ This last result offers only a short term solution. Eventually, higher Federal Reserve borrowing will lead to either a higher discount rate, which will discourage that borrowing, or to a decrease in the nonborrowed reserves target. In either case, the borrowing acts as a short term buffer. Eventually interest rates must rise sufficiently to induce one or more of the other responses mentioned in the text.

loan proceeds are used to buy investments creates the presumption that a very high percentage of the stock sale proceeds will be reinvested and, thus, effectively used to finance indirectly the original extension of credit. For these reasons, the extension of bank credit for merger related purposes is likely to have minimal effects on the cost and availability of credit. It is not likely that such loans would have more than transitory effects on interest rates, required bank reserves, and the growth of the monetary aggregates.

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FOR RELEASE UPON DELIVERY
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Wednesday, January 27, 1982

STATEMENT OF
THE HONORABLE ROGER B. PORTER
COUNSELOR TO THE SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON ECONOMIC STABILIZATION
OF THE HOUSE COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity in my capacity as Counselor to the Secretary of the Treasury to state my views on the subject of productivity and to review with you the establishment by the President of the National Productivity Advisory Committee.

The subject of productivity has generated a great deal of attention, and with good reason: adequate productivity growth is essential to a prosperous economy. Achieving steady increases in a nation's standard of living and in its ability to meet its security needs is greatly affected by productivity developments.

This subcommittee has played a major role in focusing attention on our productivity problems. Many individual members of this subcommittee have done much to identify ways in which we can improve our productivity performance in this country. Those of us who care deeply about improving productivity are encouraged by the contribution you have made and are pleased to join you in this important effort.

The Nature of the Productivity Problem

Much of the current interest in productivity is motivated by the widely shared view that the United States has a productivity problem. As with any popular subject there are many myths and misperceptions regarding U.S. productivity. In responding to our productivity challenge, it is important to have a clear understanding of the nature and magnitude of the problem. Five fundamental features of our productivity situation can help in delineating the shape of the challenge before us.

First, absolute U.S. productivity levels are still higher than those of other major industrial countries, but the gap is closing rapidly due to lower U.S. productivity growth rates. Although international comparisons are notoriously difficult, the Congressional Budget Office estimates that U.S. productivity is about 10 percent ahead of most European countries. Japan is even farther behind, despite common misperceptions. The overall level of Japanese productivity is only about 70 percent of that prevailing in the United States.

What concerns most observers is that the Europeans and the Japanese are closing the "productivity gap." Three decades ago U.S. productivity led that of its nearest European competitor by

40 by 50 percent. That the U.S. no longer enjoys this lead is attributable to more rapid productivity increases in other industrial nations.

Second, overall U.S. productivity growth rates have declined sharply in recent years. The average rate of annual productivity growth in the United States from 1948 to 1968 was 3.1 percent. This rate averaged only 2.2 percent in the next five years and fell to 0.6 percent in the 1973-1980 period.

Third, other industrial countries have also experienced declining productivity growth rate increases since 1973. In some countries the slowdown has been as sharp as in the United States. With the exception of Canada, however, most other major industrial countries continue to have larger annual average gains in gross domestic product per employed person than does the United States.

Fourth, there are significant variations in productivity growth rates among different sectors of the economy. Not only are there marked differences among industrial sectors in levels of productivity, there is also considerable variation in the sectoral rates of change in productivity, and the difference in sectoral growth rates is widening over time. Moreover, with the exception of the communications and financial sectors, the decline in productivity growth accelerated dramatically in the period since 1973.

For example, within manufacturing, motor vehicles experienced an increase of approximately 4 percent per year in the 1973-78 period while steel experienced a decline of 1 percent. Productivity declines also occurred in the construction and mining sectors. In mining the decline in output per manhour averaged 5.2 percent per year for the 1973-79 period, while in construction the decline in labor productivity started in the 1968-73 period (-1.8 percent per year) and accelerated during the 1973-79 period (-2.8 percent per year). In several other sectors -- wholesale and retail trade, and finance, insurance, and real estate -- the rise in output per manhour during the years 1973-79 averaged less than 1 percent annually.

Fifth, students of productivity do not fully agree regarding the causes of the slowdown, and there is even less agreement when attempts are made to quantify the causes. There is agreement, however, that many factors have contributed and that there is neither a single cause nor a single solution to our productivity problem.

Moreover, there is a general consensus among analysts that the single most important determinant of productivity per manhour is the quantity of capital -- plant and equipment -- per worker.

Other things being equal, when the amount of capital grows more rapidly than the amount of labor, productivity per worker increases. Maintaining a given rate of productivity advance requires increasing the ratio of capital to labor at a steady rate. If the gain in the capital:labor ratio slows, the gain in productivity will also slow.

The ratio of the net stock of capital, excluding capital applied to pollution abatement, to manhours grew at an average annual rate of 2.9 percent in the 1948-68 period, then declined to 1.8 percent per year in the 1968-73 period, then declined even further to 0.7 percent per year in the 1973-80 period. Thus, an important cause of the slowdown in the rate of increase in productivity per manhour has been a dramatic decline in the rate of growth of capital per worker.

While the capital:labor ratio is certainly a very important determinant of productivity per worker, it is not the only determinant. Other factors affecting productivity include: the age-sex mix of the labor force, shifts in capital and labor from one sector of the economy to another, government-mandated regulations, the dramatic increase in energy prices since 1973, and the rate of advance in technological knowledge and innovation. And this list could easily be expanded many fold.

In short, our productivity challenge is not a single problem but a host of problems that affect almost every aspect of American life -- manufacturing, high technology, health care, education, natural resources and mining, finance, retailing, transportation, small business, and the professions.

The productivity challenge we face is one of the most important our nation will confront during the 1980s. It is a complex set of problems affecting governmental and nongovernmental institutions and every sector of our economy. Reversing this decline will require much effort on many fronts. It will require the united efforts of business, labor, and government. Moreover, it is not a partisan issue and happily this is widely recognized by concerned Americans of all political persuasions.

The National Productivity Advisory Committee

This view of the productivity challenge we face is important in understanding the mandate, composition, and organization of the recently established National Productivity Advisory Committee. Concern about Amercia's productivity problem is at least a decade old. Over the past ten years, five different national productivity committees, councils, commissions, or boards have been established by succeeding administrations. Now, with the establishment last November of the National Productivity Advisory Committee by President Reagan, we have a sixth.

Mandate. Recognizing that defining the nature of our productivity challenge is difficult since it affects virtually everthing, the executive order establishing the Committee directed that the Committee should "advise the President and the Secretary of the Treasury through the Cabinet Council on Economic Affairs on the Federal Government's role in achieving higher levels of national productivity and economic growth."

This mandate to concentrate on the Federal Government's role helps define the task facing the Committee and helps focus its attention on a specific set of issues. Needless to say, it will not be possible for the Committee to examine every activity of the Federal Government that influences productivity, but this mandate concentrates the Committee's efforts on those elements of our productivity challenge closest to home where the government's capacity for change and improvement is greatest. It is always tempting to concentrate attention on changes others should make rather than on those things within our power to influence most effectively.

Composition. The composition of the National Productivity Advisory Committee reflects the President's conviction that any effort to significantly improve our productivity growth must involve business, labor, and academia, must include individuals with experience and expertise in the broad array of sectors in our economy, and should draw upon able and talented men and women regardless of party affiliation.

The President has assembled a group of outstanding individuals to serve on the National Productivity Advisory Committee. Many of them are well known to the members of this Committee. They include the heads of several major corporations, as well as executives of some very successful small businesses. Five prominent labor leaders serve as members of the Committee and four of the nation's leading academic economists are members of the group. The Committee's chairman is William E. Simon, former Secretary of the Treasury. In all there are 34 members of the Committee, only one of whom is currently a federal official, but many of whom have worked in both the public and private sectors. Together, they represent an impressive collection of human expertise and experience that covers a vast cross section of the nation's economy.

Organization. In a real sense virtually everything the federal government does affects productivity in one way or another. Thus, there are an infinite number of ways of approaching the productivity problem and an infinite number of subjects on which committee members might focus their attention. In organizing its work, the Committee established four subcommittees at its first meeting eariler this month. The four subcommittes are:

1. Capital Investment;
2. Research, Development and Technological Innovation;
3. Human Resources; and
4. The Role of Government in the Economy.

Chairman Simon has designated the following individuals to serve as chairmen of these subcommittees: Martin S. Feldstein, president of the National Bureau of Economic Research, as chairman of the Subcommittee on Capital Investment; Dr. Lewis Branscomb, vice president and chief scientist, IMB Corporation, to serve as chairman of the Subcommittee on Research, Development, and Technological Innovation; John T. Dunlop, former Secretary of Labor, to serve as chairman of the Subcommittee on

Human Resources; and Professor Paul W. MacAvoy of the Department of Economics at Yale University to serve as chairman of the Subcommittee on the Role of Government in the Economy. Each of these individuals is a highly respected expert in the subjects that their subcommittees will consider.

The division of the Committee into these four subcommittees was necessary to provide for working groups of manageable size. It also recognizes the fundamental fact that productivity is not a single problem, but many problems that need to be approached in different ways.

There are three other important characteristics of the National Productivity Advisory Committee that set it apart from its predecessors:

1. It is not designed to produce another report or study of the productivity problem. Unlike previous efforts which produced annual reports or studies, the executive order establishing the National Productivity Advisory Committee neither mandates nor requests the Committee to produce a written report. The President has said that he does not particularly care whether he ever gets a formal written report from the Committee. What he is looking for are concrete recommendations and specific suggestions as to what additional steps the government can take to enhance productivity growth. In this sense, the productivity advisory committee is similar to the President's Economic Policy Advisory Board, a group of distinguished nongovernmental

economists who periodically advise the President on matters relating to economic policy.

2. The National Productivity Advisory Committee is closely linked to policy development within the executive branch. Rather than operating on its own, the executive order directs the Committee to report to the President and the Secretary of the Treasury through the Cabinet Council on Economic Affairs (CCEA). The CCEA is one of six cabinet level bodies that coordinate policy across the various departments and agencies of the executive branch. It is chaired by the Secretary of the Treasury in the absence of the President, and its other members include the secretaries of State, Commerce, Labor, and Transportation, the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisors, and the United States Trade Representative. The CCEA meets regularly, usually on Tuesdays and Thursdays, to consider a wide range of economic issues. This week it will hold its seventy-second meeting. In considering the recommendations of the National Productivity Advisory Committee, the CCEA will assure that the work of the Committee is fully integrated into the administration's on-going policy development process, a characteristic sometimes missing in past productivity advisory efforts.

3. This characteristic is reinforced by the Committee's staffing arrangements. Rather than have its own independent staff, the Committee will draw on resources within the executive

branch for its staff support. The Executive Secretary of the Cabinet Council on Economic Affairs will also serve as the Executive Secretary of the National Productivity Advisory Committee.

A senior subcabinet official will work with each of the subcommittees to assist in developing the necessary staff support. This individual will work with the subcommittee's chairman and the executive secretary of the Committee to determine how best to respond to requests for information or analysis. If the issue involves several departments and agencies, the executive secretary will form an interagency working group to provide staff assistance or draw from one of the existing working groups of the Cabinet Council on Economic Affairs. This should help insure that the work of the productivity advisory committee is fully integrated with the administration's on-going policy development process.

Summary

It is clear that America's productivity problem is not a temporary phenomenon. Nor will it be solved overnight. The solution to our productivity challenge will require a concerted effort by many people and institutions: business, labor, government, and academia. It will require many changes, large and small.

The National Productivity Advisory Committee is a part of this effort. We are pleased that the Committee includes members with broad experience and diverse backgrounds. The Committee is open to suggestions from all quarters as it commences its deliberations. The suggestions of members of the Subcommittee on Economic Stabilization and others in the Congress can greatly assist the Productivity Advisory Committee as it develops specific recommendations for ways in which the Federal Government can contribute to achieving higher levels of national productivity growth.

TREASURY NEWS

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REMARKS BY THE
HONORABLE BERYL W. SPRINKEL
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
BEFORE THE
RESERVE CITY BANKERS
NEW YORK, NEW YORK
FEBRUARY 1, 1982

Good evening.

Let me take the next few minutes to talk about monetary policy as viewed by this Administration. Let me pose two questions to you. First question: Does eating food make children grow? The second question is: What in the world does the first question have to do with monetary policy? I will get to the answers in a minute.

Any reasonably well thought out program or policy has a philosophic framework, and ours is no exception. I recognize that I am talking to a highly sophisticated group of bankers and financial professionals here. So please don't think that I am insulting your intelligence when I digress for a moment, and talk about some basics. It is essential to do just that because "the basics" is where the truth is -- and because our policy -- anyone's policy -- derives from an understanding of what the basics are.

So let's start with two fundamental ideas. First, we believe that economic systems function best when they are free, open and relatively unfettered. Like the human body, an economy enjoys healthy growth when the flow of energy and resources is not restricted. And, also like the human body -- and all biological systems -- there are powerful self-correcting forces which are built into the system.

The second basic point has to do with money -- more precisely, with what money is <u>not</u>. Belaboring this point with this audience would be like preaching to the choir. But there is a <u>serious</u> misunderstanding among the general public (and, I might <u>add, among</u> the press) about money.

Money is just money; a medium of exchange. It is not the football game, it is only the ticket into the stadium. And money is not credit either. There is money when there are units of currency or deposits. There is credit when any party in the economy lends an asset, monetary or otherwise, to another party.

An economy is fundamentally an array of labor, capital and creative activity. Now staying with the basics for a moment longer: For money to function properly, the size of the money stock must bear an "equivalency" or proper relation to the size of the economy which it, in essence, services.

These, then, are our starting points. Economic systems are efficient to the degree that they are free and open. And money -- that is currency and deposits -- is not a real asset. It is a man-made facilitating mechanism that is fundamentally representational in nature.

Monetary Policy

The central feature of the monetary policy of this Administration -- I'm sure you have heard this a thousand times -- is that we want a slow, stable growth in the money supply.

Ideally, the supply of money should expand at exactly the same rate at which the real economy is expanding. If the money supply grows too fast, you get inflation; if it is highly volatile, it engenders volatile financial markets and uneven economic performance. If it grows too slowly, it depresses real growth and unnecessary unemployment occurs.

In retrospect, the Fed decelerated money growth last year faster than we had anticipated, falling below the low end of its own target range. And while this was less than ideal, the last thing we want now is a gusher of new money creation as quick compensation. That would put us right back into the old roller coaster monetary policy that has been so disastrous in the past. Money growth under the Carter Administration was not only too rapid but too erratic, and it brought us high inflation and interest rates. The key words in this Administration are moderate and steady.

This policy is yielding, and will continue to yield, lowering interest rates. Many are now saying that, with a large Federal deficit looming ahead, interest rates will go up. In a sense, they are saying that the law of supply and demand is controlling: the deficits are going to increase the demand for money relative to its supply so interest rates must go up.

What's wrong with this forecast? Well, first of all, it reflects that same misunderstanding of what money is not. Government deficits produce a greater demand for credit. The Federal Reserve Board controls the money supply and, therefore, bank credit. It does not -- it cannot -- control total credit.

Secondly, the tax cuts now in place are serving to increase the size of the private savings pool, thereby increasing the funds available to the credit market. In addition, as inflation decelerates there is a subtle but very significant shift underway. Investors -- of all sizes -- are shifting a portion of their portfolio from tangible assets to financial assets. Even if that portion is as small as one or two percent of total portfolio, it represents tens of billions of dollars of new resources flowing into the credit markets.

Lastly, the historical economic data shows -- in an overwhelming way -- that interest rates rise and fall as inflation rises and falls. I am not saying that deficits are not an evil. I am saying that deficits are not the major cause of high interest rates and, furthermore, that deficits, while we don't like them, are not incompatible with a responsible monetary policy. The total public sector deficits of Japan and Germany are much larger, as a percent of GNP, than ours. And yet, these countries have relatively low inflation and low interest rates. The primary reason for this lies in their responsible monetary policies and in their robust rates of savings.

Most of you are aware, I am sure, that we have proposed legislation allowing for a variable-rate savings bond. If our proposal is enacted into law, it will assure long-term investors of an equitable return throughout their holding period. This recommendation stems from our original premise: the more free and flexible a system is, the more efficient it is. Beyond the basic fairness and soundness of the idea, there is very nice little side benefit. It will save the Government money because as interest rates decline generally -- as we are confident they will -- bond rates will also decline, reducing Federal borrowing costs.

It is also this same philosophy that led Secretary Regan to announce -- and continue to push for -- comprehensive bank deregulation legislation. How much sense does it make to have a free economy and hobble the financial institutions that exist to serve that economy?

I mentioned a moment ago that the basics are where the truth is. And the truth, in this case, is that market reality has transcended our antiquated legislation and regulations of the Glass-Steagall era of the 1930's.

For example, the question is not so much whether the investment bank/commercial bank distinction of Glass-Steagall is right or wrong. The question rather is: given the modern electronic revolution and the financial requirements of today, whether such a distinction is meaningful.

Consider for a moment that one of your competitors is now Merrill Lynch which offers mortgages, check-writing, trust and estate planning and money management.

Another of your competitors, Sears and Roebuck, has long offered insurance and consumer credit. It has recently acquired the nation's fifth largest real estate brokerage firm, decided to establish a money market fund, and is also the largest savings and loan holding company in America.

Your competitor, General Electric, now offers real estate loans, second mortgages, commercial real estate financing, mortgage insurance and leveraged leasing. And the list goes on and on.

On another front, we have taken a hard look at interest rate differentials on thrift deposits. Interest rate ceilings and the special authority given to S&Ls were to have been temporary -- for 12 months. Fifteen years later, the restrictions are still there.

We are hopeful that the DIDC -- Depository Institutions Deregulatory Committee -- will soon begin the phase out of the ceilings. We are proposing a plan that would eliminate rate ceilings beginning with longer term (3-1/2 year) maturities to give thrift institutions time to put their expanded investment powers to use.

Along the whole range of the financial services industry, the realities of the marketplace have changed. We -- the government -- are simultaneously trying to catch up and get out of the way. Indeed, you might say we are trying to catch up by getting out of the way. Will Rogers once offered some advice that may be appropriate here. He said, "Even if you're on the right track, you'll get run over if you just sit there."

Money is fungible. Fungible, coming from the Latin, fungi, literally means to perform a function. We are urging bank deregulation so that financial institutions can be free to offer the full range of functions that money can provide for the customer.

The International Dimension

In the international area, our views, I think, are clear and well known. We are resolved not to intervene in exchange markets except in extraordinary circumstances. We have come under criticism from some of our foreign friends -- particularly in Europe -- for pursuing what they call a policy of "benign neglect."

By allowing the dollar to rise last year without any countervailing intervention, some believed we were forcing up interest rates in other countries and hurting their economies. And we have, on occasion, been branded as callous and insensitive to our economic trading partners.

Now there are several problems with this view. First, it does not completely square with the facts. Ocasionally, market participants have cited interest rate movements as the main factor in their assessment of exchange rates. But more often, there has been no correlation between exchange rate movements and changes in interest rate differentials.

Secondly -- once again getting to basics -- there is an inherent efficiency in free and open exchange market operations, and "concocted" government buying and selling of currencies inhibits that built-in efficiency.

Exchange markets are large and complex, and the underlying relationships which determine exchange rates are not so clearly defined that any individual or government can tell you ahead of time what the exchange rate should be. And if they do tell you, they are almost certain to be wrong. When governments intervene in exchange markets, they are just as likely to be guessing wrong on a very grand scale -- throwing confusing signals into the market and wasting public funds. The facts show that, despite the billions of dollars governments have spent to intervene in foreign exchange markets, they have never been able to effect the long-term equilibrium or direction of rates. So, fundamentally, we believe that intervention to fix or manage exchange rates is doomed to failure and will continue to be a waste of money.

Some people are jokingly saying that the motto of the Postal Service these days is: "Neither snow, nor rain, nor gloom of night stays our couriers from the swift completion of their appointed rounds.....so there must be some other reason."

Well, to those who say a strong dollar causes high interest rates abroad, I say: There must be some other reason. Look at the fundamentals. The answer has to do with that old question: What is money?

Money is only a kind of language. Its core purpose is to represent the real assets in an economy. Once we are clear on that, it becomes clear that currency fluctuations are based primarily on how the marketplace perceives the economy that the currency represents.

European currencies have been weak primarily because of Europe's own economic and political situation. Europeans claimed the dollar became strong vis-a-vis their currencies as a result of our high interest rates last summer. But as our rates declined relative to theirs, the dollar continued strong. I don't think it's to suprising that the marketplace thinks the Reagan Administration policies will produce a strong American economy -- that is, less inflation and more real growth -- while at the same time finding European economic policies and prospects in greater disarray.

This perspective on money also goes a long way toward explaining this Administration's policies toward the IMF and the multilateral development banks. As you know, we have opposed the allocation of additional Special Drawing Rights -- or SDRs -- at this time. SDRs, like any other currency, must bear a certain "equivalency" or corrrelation to the economy they are reflecting; in this case, the world economy. In light of the large liquidity today in the world marketplace, it has been our judgment that issuing additional SDRs at this time would do much more to fuel world inflation than it would to foster real growth. As circumstances change, of course, we will continually reassess our position.

You are also aware, I suspect, that we place a great deal of importance on insisting on conditionality, not only for World Bank and IMF loans to developing countries, but for all loans by the World Bank and the other multilateral development banks. Now, contrary to the popular imagery you see in the press, we are not tough on loan conditionality because we are mean and cold and don't care about the plight of the poor. In fact, as is often the case, exactly the opposite is true. We are tough on conditionality precisely because we care so deeply about the lesser developed countries. Because, again, what is really important is the structure and direction of a nation's economy. And it does little good simply to pour credit into an economy that is itself headed for disaster. Poland is a sad illustration of this point.

Domestically, when the Federal Reserve monetizes the debt, it is, in essence, printing new money and giving Treasury a loan -- with no conditions. Whether it be domestic or international, the principle is the same: Credit without fundamental economic change is not only not helpful, it is potentially disastrous. But by hanging tough on loan conditionality, it is easy to be cast as the ogre because, in the <u>short</u> run, making credit available <u>seems</u> to help.

<u>Conclusion</u>

In summary, we must view monetary policy, whether it be domestic or international, as a means to an end. And the end -- the goal of this Administration -- is to get real growth up and inflation and interest rates down.

Maybe you think I forgot about that strange question about kids and food. We tend to think that children eat and that makes them grow. It does not work that way. What often seems to be obvious turns out not to be correct. The physical growth of a child is an inate drive within their biological make-up. As the body develops it demands food to replace the expended energy and perpetuate the <u>on-going</u> growth. Growth <u>creates</u> the demand for food -- <u>not</u> the other way around. Stuffing a kid with too much food doesn't make him grow faster; it makes him sick. Similarly, injecting a lot of money into an economy does not make it grow faster; it just makes it sick.

As the economy grows according to its own inherent rhythm and dynamism, that creates a legitimate need for additional money. Economies, like people, have a natural tendency toward creative growth and toward self-correction. Money exists to <u>follow</u> and facilitate that activity; not to make it happen. If we can understand these fundamentals -- and hold true to them -- we are in for a future of real and sustained non-inflationary growth.

Thank you.

# TREASURY NEWS

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Address
by
The Honorable Beryl W. Sprinkel
Under Secretary for Monetary Affairs
Department of the Treasury
before the
Conference on Wall Street and The Economy
New York, New York
January 30, 1982

"The Low Interest Rate Bias of the Reagan Administration"

We all know, of course, that economics is an inexact science. And predicting the economic future is a dangerous business. An economist is a person who knows tomorrow why the things he said yesterday didn't happen today. And I sometimes think it is best to take the advice of the man who said, "If you must forecast, forecast often."

It is inevitable and understandable that those in the forecasting business will vary by a percentage point or two when projecting economic growth, inflation or interest rates. If there is one thing that is perfectly clear it is that the future is not perfectly predictable.

But what is baffling now is that many economic analysts do not even agree on the direction that interest rates will head. Now why is this? I think there are basically four reasons. First, there is a difference of opinion over the relative power of market forces.

The bearish fellows believe, I think, that the level of interest rates will be forced up by a forthcoming expansion of the demand for credit colliding with an alleged restriction of supply by the Federal Reserve. Big borrowing by the government puts upward pressure on interest rates. Economic growth produces corporate demand for loans for business expansion -- which also puts upward pressure on interest rates. And if you have big government deficits and economic expansion -- as we will have this year -- then you will supposedly get a double whammy effect on credit demand. If you add to this the popular notion that the Fed is keeping credit tight, you can see why some believe that interest rates will go through the roof.

Now, it is interesting that this view is borne of classic economic conservatism. This argument appears to be saying that it is the law of supply and demand that is controlling. A greater demand to borrow money -- especially when its supply is being held in check -- will supposedly result in a higher price for the money. And the price of money, it is often said, is interest rates.

All that sounds very compelling doesn't it? And it sounds as if it came right out of Adam Smith's Wealth of Nations. Before I get to the other point of view, let me say that there is some truth to this view. The law of supply and demand is alive and well in the market place and increased demand for credit does exert pressures -- on interest rates.

So what is the case for declining interest rates? Our case, it turns out is also based on Adam Smith -- the part in his book where he says people would rather make money than lose money.

If you are in the business of lending money, and you are trying to anticipate your future profit margin, you begin to think about future risks: possible default, future tax liabilities and future inflation. Even if that borrower is the most credit worthy sort, you are going to charge him higher interest rates if you think he will be paying you back in inflated -- and therefore less valuable -- dollars.

If you think the rate of inflation will be low in the future, you can reduce your rates and still expect to make a profit. And if you don't lower your rates accordingly, you can bet your competitor will.

So that as inflation subsides and much more importantly -- as the belief that inflation will be lower becomes prevalent -- interest rates start down.

In a nutshell, then, we have one view that says an increase in the demand for credit puts upward pressure on interest rates. The other view says that declining inflation -- due mainly to responsible monetary policy -- puts downward pressure on interest rates. Which view is right? My answer may surprise you. Both views are right. There is pressure pushing rates both ways. But the downward pressure is much stronger than the upward pressure.

If it rains over there in the East River it will tend to raise the level of the river. But if the tide is running out, the level of the water will drop no matter how hard it rains. It's a question of which force is predominant.

Now if the argument in the abstract leaves you cold, let's forget theory for a moment, and look at history.

In the Fall of 1975, as post-recession real economic growth was gaining speed, interest rates moved up for a few weeks. However, the Fed maintained a steady hand on the tiller.

And what happened? As the economy continued to grow that Fall and into the following year, inflation continued to go down.

This was a period, please remember, of massive Federal deficits: 66 billion in Fiscal year '76. A deficit which, as a percentage of GNP is larger than the deficit projected for this year. And yet there was solid economic growth. And as inflation was declining to less than 5%, interest rates continued their downward trend. Not until late 1976 did rates move up. Because not until late 1976 was money growth increased sharply.

Between 1976 and 1980, the money supply here in the U.S. grew at almost 8% per year. From the summer of 1980 until last spring it grew at an explosive annual rate of 12%. And, of course, inflation and interest rates rose accordingly. The problem is even more complicated because money growth was not only too rapid; it has been much too erratic.

When the markets see a money growth pattern they increase interest rates to cover for future inflation. When the market sees the money supply shoot up and don't know if they are seeing a pattern or not, they raise interest rates even further to cover for the unknown.

Traditionally, you know, things, worked like this: The Fed would pump out a lot of new money. And for a period, there would be heightened economic activity with no perceptible change in inflation. Then, later on, gradually inflation would start to move up. And, also gradually, interest rates would start up.

Then, money supply growth would be curtailed to dampen inflation. But these "cooling off" periods were typically short-lived and when new money was cranked out again, inflation rose to new highs. Each subsequent inflation and interest rate peak was higher than previous peaks. And subsequent troughs were likewise higher than earlier troughs.

Today, the market place has become very astute. It sees very clearly the cause and effect relationship between money supply, inflation and interest rates. What you might call the "eternal infernal triangle." One leads to the other which leads to the other. Now, the market doesn't even bother to wait for the middle step: visible inflation. Instead, as soon as weekly reports of high money growth come out, interest rates -- immediately -- move up. That is exactly what began to happen 3 months ago.

Short run gyrations in the money supply are, of course, often just that: near term vacillations of little significance. But, given the history of the past 15 years, how is the market to know whether or not it is witnessing the beginning of a long-term trend? It doesn't know, and therefore often assumes that it is, until proven otherwise. That is why money growth needs to be moderate over the long run, and steady over the short run. And by short run I do not mean week-to-week. I do mean a steady, consistent path over several months.

There is no example in history -- not one -- where there has been sustained high inflation and moderate, stable growth in the money supply. And, the other half of the picture is that there has never been an economy which has -- over any length of time -- had high interest rates and low inflation. Interest rates are a function of four things: inflation, expectations about future inflation, the real return component <u>and</u> the uncertainty premium. But don't take my word for it -- <u>please</u>. Look at the data. And if you do, you will find that it is compelling and overwhelming.

Now the second reason why there is disagreement over the future direction of interest rates has to do with a fundamental -- and therefore critical -- misunderstanding of what money is not. Money is money. It is a device which is used to facilitate economic transactions. It is <u>not</u> credit. And credit is not money.

Webster's Dictionary defines inflation as "an increase in the volume of money <u>and credit</u> relative to available goods resulting in a substantial and continuing rise in the general price level." Notice, first, that this definition makes no mention of wages, OPEC, Social Security taxes, or any of the host of the other alleged inflationary factors. Therefore, you might conclude that the people at Webster's are monetarists, or that I, as a monetarist, would accept their definition. I do not.

Instead, this definition is too inclusive. Attributing inflation to expansion of <u>credit</u> is an example of an erroneous popular notion which is responsible for much of the misconceptions about the President's economic program.

I prefer a definition such as the one offered by Random House. Inflation, they write, is "a substantial rise of prices caused by an undue expansion in paper money or <u>bank</u> credit."

If someone believes that inflation is caused by excessive money and credit, he would also believe that an effective anti-inflationary policy would have to restrict the supply of money and credit.

Unfortunately, many people view our monetary policy as an attempt to do just that. And, of course, they see a conflict: the Fed is seen as restricting the supply of credit while the budget deficit represents an increase in credit demand. When supply declines and demand increases, the result is obvious -- prices rise.

But, you see, the argument ends up wrong because it starts out wrong. The Fed is dealing with the supply of money. Unless the budget deficit is monetized -- which we do not intend to do -- it affects only the demand for credit. Money is not credit. Growth in credit is not inflationary. Growth in money is inflationary.

The tax cut element of the President's program was designed specifically to increase savings and thereby expand the supply of credit. And this has already started to happen.

The misperceptions are often compounded because many also fail to make the distinction between total credit and bank credit.

Credit is generated when any party in the economy lends an asset, monetary or otherwise, to another party. There is bank credit when a bank lends dollars to another party. The difference is that money is also created when bank credit expands. Money is only redistributed in all other borrowing - lending transactions.

Now the level of bank credit available is affected by the actions of the Federal Reserve Board. The Fed does not have effective control over total credit. In its efforts to control money, bank credit is constrained. But there is a whale of a lot of credit out there that is not bank credit.

It is popularly assumed that interest rates are the "price" of money. They are emphatically not the price of money. Interest rates are the price of credit. Inflation is a change in the price of money; because the larger the supply of dollars the less is its value per dollar -- that is, reduced purchasing power.

And the price of credit rises and falls depending on -- what? In large part, depending on what people think will be the future purchasing power of money.

There is a rather subtle shift taking place in America. And failure to perceive this shift is, perhaps, a third reason for the difference of views. In periods of accelerating inflation -- which is what we had until last year - real assets tend to have a greater real rate of return than financial assets. As a result, over the last several years, savvy investors have tended to move out of such things as stocks and bonds and into such things as houses, land and antiques.

Conversely, in periods of decelerating inflation there is a tendency for investors -- institutions and individual households -- to shift their portfolios somewhat from real assets to financial assets. The reason for the shift, of course, is that investors see a shift in the rate of return of one category of assets relative to the other category. I am not saying that everyone is selling rugs and condominiums and buying stock. But there is some of that going on.

And in a 4 trillion dollar economy -- which we are on the verge of having -- a shift of 1 or 2 or 3 percentage points puts tens of billions of dollars into the system in the form of expanded potential credit. Thanks to declining inflation, that phenomenon is already happening, and additional credit needed for economic expansion is forming rapidly. This will tend to reduce the upward pressure on interest rates.

Finally, there is a fourth explanation of the differing "upstairs, downstairs" ideas on interest rates.

Some who say interest rates are going higher actually are saying: The Fed is going to blow it .... again. When economic recovery really picks up steam later this year, there may be some temporary upward movement of interest rates. And there is fear that, if this happens, the Fed could over-react and send a gusher of new money out. Now, if that were to happen, I heartily agree, we would be in for high interest rates. Fortunately, I am confident that that will not happen.

We have now an Administration and a Federal Reserve Board that are unified in their determination to hold to a long-term deceleration in money supply growth.

This Administration is a <u>low</u> interest rate Administration. But please remember, we inherited a pretty tough situation. You know, when Don Regan and I first went down to Washington we felt like the two teenage boys who were on a tour of an art gallery, and found themselves alone in a room of modern sculpture. Staring at the twisted pipes, broken glass, and tangled shapes, one of them said, "Let's get out of here before they accuse us of wrecking this place." In the last twelve months we have had to spend a great deal of time repairing the wreckage from the last Administration.

You are aware that the President's basic economic package consists of four elements: reduce spending, reduce regulation, reduce money growth and reduce taxes. The ultimate goal, of course, is to reduce inflation and increase real economic growth in America. In other words, we are in town to subdue stagflation.

Getting interest rates down is critical to the success of that overall program. In one sense, governments cannot force interest rates to come down. But governments can set up the proper conditions in the economy so that those rates will fall naturally of their own weight. And that is precisely what we are doing.

We have a tight money-easy credit program. We may not be perfect, but -- contrary to some of our critics -- we are smart enough to study and learn from history. And history has shown very clearly what reduces interest rates. We are taking those steps and I think a year from now you will be able to look back on 1982, as history, and see a period of real growth and declining interest rates.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

For Release Upon Delivery
Expected at 1:00 p.m.
Monday, February 1, 1982

The Honorable Beryl W. Sprinkel
Under Secretary for Monetary Affairs
before the
New York Society of Securities Analysts
New York, New York
February 1, 1982

I. Introduction

Good Afternoon.

It's good to be back here in New York; the citadel of capitalism.

I know that being a group of top notch securities analysts, you are really only interested in one thing. What does Sprinkel think is going to happen in the future?

Well, I've been in the forecasting business long enough to know that only one thing is certain: that is that nothing is certain.

An economist, I've discovered, is someone who knows tomorrow why the things he forecast yesterday didn't happen today.

Well, what about the future? I'd like to break my remarks into two parts: what is the government going to do and what is the economy going to do.

The Government

First, I think it is crystal clear from the President's State of the Union address last week, that we are going to keep a steady course with our four part economic program. It is a sound program. In fact, it is the only program that can bring real non-inflationary growth to the American economy.

R-593

Tax Reductions

First, the comprehensive tax cut program is in place and it is going to stay in place.

Deregulation

Second, we are engaged in a serious and comprehensive effort to do away with uneeded regulations on business. This is a part of our program that is difficult to quantify. But we are making progress and the results are going to be significant.

The Federal Register -- the publication that contains new federal regulations -- contained 23,000 fewer pages last year than in 1980. That should tell you something.

And I might mention that one of the cornerstones of the whole deregulation effort is bank deregulation. Legislation just sent to Congress last week -- if passed -- would go a long way toward freeing up the financial services industry to allow it to be more open and competitive and, at the same time, to provide better financial services for the customer.

Spending Reductions

The third -- spending reductions -- is probably the toughest area. As you know, the President is going to submit his budget request to Congress early next week.

And I am not at liberty to give you a detailed sneak preview. Suffice it to say that we are deadly serious about making continuing reductions in the rate of growth in federal spending.

The budget deficit for this year is going to be big -- way too big. But it is going to be below the $100 billion mark and it will go down -- not up -- in succeeding years.

Stable Monetary Growth

Finally, as you know, from the very beginning we have said that we want a steady, moderate growth in the money supply.

The Federal Reserve Board and the Administration are united on this front.

The Fed undershot its targets last year. And over the past 3 months there has been a troubling rapid increase in the money supply.

But I am hopeful that this will prove to be a short term deviation and that the Fed will get back into its own moderate growth target range for this year.

The Economy

The Recession and Recovery

Clearly, we think we are near the bottom of this recession. And with decreasing inflation, and in-place tax cuts and slower money growth, we have the foundations for a vigorous recovery.

If you take a look at the previous 7 post-World War II recessions, the average -- not best -- average growth in real GNP coming out of the recession has been 6.9 percent over the first four quarters.

We have strong reason to believe that this recovery will also be strong for a number of reasons. But the primary reason is that we are in the position -- perhaps serendipitously -- of having a significant tax cut in place early in the recession.

Due at least in part to the tax cuts, the rate of savings in this country is -- finally -- on the upswing. In 1975 personal savings was 8.6 percent of disposable income. By 1980 it had fallen to 5.6 percent, and finally bottomed out at 4.3 percent in the first quarter of last year. The figure for the 1981 4th quarter was an encouraging 6.0 percent.

Encouraging Signs

Trying to find the end -- or even the beginning of the end -- of a recession is still like trying to read the tea leaves.

There are, nevertheless, some encouraging signs:

The leading indicators rose 0.6 percent in December after a very small revised dip of 0.2 percent in November.

Manufacturers' durable goods orders an important leading indicator, have shown broad-based increases in the last two months.

Housing starts are up.

Seasonally adjusted initial claims for unemployment insurance rose to the 600,000 range by early December, and declined steadily to about 500,000 by early January. Initial claims shot up to 640,000 in the week of January 9, reflecting the processing of a backlog of claims that piled up during the holiday period.

In the week of January 16, claims fell back again to 455,000. These recent swings are wide and may obscure the underlying trend. Nevertheless, the apparent movement below 500,000 is encouraging.

Consumer confidence - The Sindlinger Index of consumer confidence -- a sensitive if somewhat erratic measure -- fell from late summer to an early December low

and had risen substantially by mid-January. The University of Michigan index of consumer sentiment rose in December. The Conference Board index of consumer confidence was off some in December but typically lags behind the Sindlinger index in detecting shifts in consumer attitudes.

I don't want to place too much importance on these signals. The important point is not whether the economy started to move up last week or next week or next month.

What <u>is</u> important is that it is going to move up -- and soon. And when it does, I am confident that it will do so in a vigorous way.

What else can we say about the future?

<u>Interest Rates</u>

They have moved up in recent weeks; but I am confident that they will return to their previous downward trend.

It is baffling that many economic analysts do not even agree on the <u>direction</u> that interest rates will head. Now why is this? I think there are a number of reasons. First, there is a difference of opinion over the relative power of market forces.

The bearish fellows believe, I <u>think</u>, that the level of interest rates will be forced up by a forthcoming expansion of the demand for credit colliding with an alleged restricton of supply by the Federal Reserve. Big borrowing by the Government puts upward pressure on interest rates.

Economic growth produces corporate demand for loans for business expansion -- which also puts upward pressure on interest rates. If you have big government deficits and economic expansion -- as we will have this year -- then you will supposedly get a double whammy effect on credit demand. If you add to this popular notion that the Fed is keeping credit tight, you can see why some believe that interest rates will go through the roof.

This argument appears to be saying that it is the law of supply and demand that is controlling. A greater demand to borrow money -- especially when its supply is being held in check -- will supposedly result in a higher price for the money.

All that sounds very compelling doesn't it? And it sounds as if it came right out of Adam Smith's Wealth of Nations. Let me say that there is some truth to this view. The law of supply and demand is alive and well in the market place and increased demand for credit does exert pressures -- on interest rates.

But our case, it turns out, is also based on Adam Smith -- the part in his book where he says people would rather make money than lose money.

If you are in the business of lending money, and you are trying to anticipate your future profit margin you begin to think about future risks: possible default, future tax liabilities and future inflation. Even if that borrower is the most credit worthy sort, you are going to charge him higher interest rates if you think he will be paying you back in inflated -- and therefore less valuable -- dollars.

If you think the rate of inflation will be low in the future, you can reduce your rates and still expect to make a profit. And if you don't lower your rates accordingly, you can bet your competitor will.

In a nutshell, then, we have one view that says an increase in demand for credit puts upward pressure on interest rates. The other view says that declining inflation -- due to responsible monetary policy -- puts downward pressure on interest rates. In fact, there is pressure pushing rates both ways. But the downward pressure is much stronger than the upward pressure.

Now if the argument in the abstract leaves you cold, let's forget theory for a moment and look at history. In the fall of 1975, as post-recession real economic growth was gaining speed, interest rates moved up for a few weeks. However, the Fed maintained a steady hand on the tiller. And what happened? As the economy continued to grow that Fall and into the following year, inflation continued to go down.

This was a period, please remember, of massive Federal deficits: 66 billion in Fiscal year '76. A deficit which as a percentage of GNP, is larger than the deficit projected for this year. And yet there was solid economic growth. And as inflation was declining to under 5%, interest rates continued their downward trend. Not until late 1976 did rates move up. Because not until late 1976 was money growth increased sharply.

Now the second reason why there is disagreement over the future direction of interest rates has to do with a fundamental -- and therefore critical -- misunderstanding of what money is not. Money is money. It is a device which is used to facilitate economic transactions. It is not credit. And credit is not money.

If someone believes that inflation is caused by excessive money and credit, he would also believe that an effective anti-inflationary policy would have to restrict the supply of money and credit.

Unfortunately, many people view our monetary policy as an attempt to do just that. And, of course, they see a conflict: the Fed is seen as restricting the supply of credit while the budget deficit represents an increase in credit demand. When supply declines and demand increases, the result is obvious -- prices rise.

But, you see, the argument ends up wrong because it starts out wrong. The Fed is dealing with the supply of money. Unless the budget deficit is monetized -- which we do not intend to do -- it effects only the demand for credit. Money is not credit. Growth in credit is not inflationary. Growth in money is inflationary.

And the price of credit rises and falls depending on -- what? In large part, depending on what people think will be the future purchasing power of money.

There is a rather subtle shift taking place in America. And failure to perceive this shift is, perhaps, a third reason for the differing views. In periods of accelerating inflation -- which is what we had until last year -- real assets tend to have a greater real rate of return than financial assets. As a result, over the last several years, savvy investors have tended to move out of such things as stocks and bonds and into such things as houses, land and antiques.

Conversely, in periods of decelerating inflation there is a tendency for investors -- institutions and individual households -- to shift their portfolios somewhat from real assets to financial assets. The reason for the shift, of course, is that investors see a shift in the rate of return of one category of assets relative to the other category. I am not saying that everyone is selling rugs and condominiums and buying stock. But there is some of that going on.

And in a 4 trillion dollar economy -- which we are on the verge of having -- a shift of 1 or 2 or 3 percentage points, puts tens of billions of dollars into the system in the form of expanded potential credit. Thanks to declining inflation, that phenomenon is already happening, and additional credit needed for economic expansion is forming rapidly.

Finally, there is a fourth explanation of the differing "upstairs, downstairs" ideas on interest rates.

Some who say interest rates are going higher actually are saying: "The Fed is going to blow it .... again." When economic recovery really picks up steam later this year, there may be some temporary upward movement of interest rates. And there is fear that, if this happens, the Fed could over react and send a gusher of new money out. Now, if that were to happen, I heartily agree, we would be in for high interest rates. Fortunately, I am confident that that will not happen.

<u>The Money Supply</u>

Finally let me make a few comments about the money supply.

The past two months have provided a good example of the disruptive effects of volatile money growth. And I hope that those who still believe that high interest rates are

When the market sees a money growth pattern, they increase interest rates to cover for future inflation. When the market sees the money supply shoot up and don't know if they are seeing a pattern or not, they raise interest rates even further to cover for the unknown.

Traditionally, you know, things, worked like this: The Fed would pump out a lot of new money. And for a period, there would be heightened economic activity with no perceptible change in inflation. Then later on, gradually, inflation would start to move up. And also, gradually, interest rates would start up.

Then, money supply growth would be curtailed to dampen inflation. But these "cooling off" periods were typically short-lived and when new money was cranked out again, inflation rose to new highs. Each subsequent inflation and interest rate peak was higher than previous peaks. And subsequent troughs were likewise higher than earlier troughs.

Today, the market place has become very astute. It sees very clearly the cause and effect relationship between money supply, inflation and interest rates. What you might call the "eternal infernal triangle." One leads to the other which leads the other. Now, the market doesn't even bother to wait for the middle step: visible inflation. Instead, as soon as weekly reports of high money growth come out, interest rates -- immediately -- move up. That is exactly what began to happen 3 months ago.

The Fed is working hard not only to slow the rate of growth in money but to reduce that disruptive volatility in the system.

Conclusion

This Administration is a low interest rate Administration. But please remember, we inherited a pretty tough situation. In the last twelve months we have had to spend a great deal of time repairing the wreckage from the last Administration.

You are aware that the President's basic economic package consists of four elements: reduce spending, reduce regulation, reduce money growth and reduce taxes. The ultimate goal, of course, is to reduce inflation and increase real economic growth in America. In other words, we are in town to subdue stagflation.

Getting interest rates down is critical to the success of that overall program. In one sense, governments cannot force interest rates to come down. But governments can set up the proper conditions in the economy so that they fall naturally of their own weight. And that is precisely what we are doing.

We have a tight money-easy credit program. We may not be perfect, but -- contrary to some of our critics -- we are smart enough to study and learn from history. We are pragmatists, not ideologues. And history has shown very clearly what reduces interest rates. We are taking those steps and I think a year from now you will be able to look back on 1982, as history, and see a period of real growth and declining interest rates.

ıank you.

TREASURY NEWS

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STATEMENT OF
THE HONORABLE R.T. MCNAMAR
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE SENATE FINANCE COMMITTEE
FEBRUARY 1, 1982

Mr. Chairman and Members of the Committee:

With me from the Treasury Department is our General Counsel, Peter J. Wallison.

We are pleased to appear before the Committee to present the views of the Treasury on the Administration's bill. This bill would deny the benefits of tax exempt status to organizations maintaining private schools that follow racially discriminatory practices.

Indeed, in light of the controversy that has developed in this area in recent weeks, we are especially pleased to have an opportunity to dispel some of the confusion and misconceptions regarding the policy of this Administration both with respect to racially discriminatory schools and the appropriate role of the Internal Revenue Service.

At the outset, we wish to emphasize the following points:

The Reagan Administration is unalterably opposed to racial discrimination in any form. Further, the Administration endorses, in the strongest fashion, the principles of Brown v. Board of Education, that racial discrimination in education has no place in a free society and should not in any way be tolerated or encouraged by the Government.

Thus, the Administration believes that racially discriminatory schools, and the organizations that maintain them, should not be recipients of tax deductible contributions. However, we recognize that protection must be accorded to the legitimate exercise of religious beliefs.

While the Administration believes that the benefits of tax exemption should be denied to racially discriminatory schools, it also believes that such a position must be based on statute. However popular it would have been to come out the other way, we and the Justice Department are unable to find that Congress has yet authorized such action in the Internal Revenue Code.

It is not satisfactory to say that the tax laws permit the Internal Revenue Service to require that tax exempt organizations must comply with certain fundamental public policies. If we follow this approach, at any time the Service may go beyond racial discrimination and decide that some other policy -- such as discrimination based on sex -- requires the revocation of tax exemptions for schools which admit only women. Instead, we believe that Congress should authorize the denial of tax exemption based only on racial discrimination by passing a law to this effect. That is why the Administration has submitted the bill that is before this Committee today.

Against this background, I would like to discuss in some detail three specific areas that are of appropriate interest to the Congress and the American public. They are:

1. The chronology of events in reaching the joint Treasury and Justice decision not to file a brief in support of the position of the Internal Revenue Service before the Supreme Court.

2. The rationale for this decision.

3. A discussion of the Administration's legislation.

CHRONOLOGY OF EVENTS

Although it is unusual for any agency to recount in detail the events which led to a particular legal or policy decision, Congress has indicated a desire to inquire into this matter and there have been allegations that the decision was the result of a political choice. On the contrary, as the chronology of events will show, the decision was the result of a careful, thorough legal analysis, and was made despite a recognition of the politically unpopular nature of that decision. In fact, the events show that the Treasury and Justice Departments hoped to be persuaded that the Service's policy of administratively denying tax exemptions to schools that racially discriminate was supportable.

The decision announced on January 8 was not an easy one and in my view presented an issue that should have been confronted in 1970 when the Service, at the request of the Nixon White House, adopted a position which was then being advanced by the plaintiffs in the first <u>Green</u> case. In that case, plaintiffs argued that the Service was authorized to deny tax exemptions to racially discriminatory schools because all tax exempt entities had to be "charitable" in the common law sense amd as such had to pursue certain fundamental public policies. One of these fundamental public policies was non-discrimination on the grounds of race.

In adopting the position of the plaintiffs in <u>Green v. Connally</u>, the Service achieved a satisfactory outcome in that particular case; it could deny tax exemptions to racially discriminatory schools. But there was a broader issue involved, which was not adequately considered at the time. If the Service could require tax exempt schools to follow a policy of racial non-discrimination, could it also impose other policies on the ground that they too were Federal public policies? In other words, did this legal principle establish a basis for IRS actions which went well beyond the laudable objective of prohibiting racial discrimination?

After eleven years, when it came time for a subsequent Administration to file a brief in the Supreme Court endorsing the legal theory adopted by the Service in 1970, that issue had to be faced squarely. In December 1981, as the time for filing a Supreme Court brief approached, the question could no longer be avoided, and after extensive review of the law the Treasury and Justice Departments were compelled to conclude the theory adopted by the Service in 1970 could not be rationalized under existing statutes on either a legal or a policy basis, because it would confer on the Service a breadth of discretion that no administrative agency should have.

The decision to grant Bob Jones University its tax exemption was made as a matter of policy and law, and involved politics only in its broadest and best sense -- the mandate of the Reagan Administration to assure that the Government of the United States acts responsibly and in accordance with the laws enacted by Congress. Let me summarize what the Chronology of Events shows and include all my contacts with the White House.

I first became aware that there was a concern over our legal position in the Bob Jones case when Deputy Attorney General Ed Schmults called me on the evening of December 8 and asked if I were aware of the Bob Jones case. I indicated I knew of its existence and that it involved tax exempt status for religious schools that practiced racial discrimination. He indicated that the Justice Department was reviewing the legal papers it was preparing for the Supreme Court on December 31. He asked that I look into the matter because it involved important policy issues and get back to him.

I subsequently informed Secretary Regan about the Justice Department's concerns in the Bob Jones case sometime during the week of December 14, at one of the frequent meetings we have during any given week. He did not suggest that I come to any particular conclusion. Rather, he indicated he wanted to be kept apprised over the Christmas vacation.

As we reviewed the legal basis for our position, the Treasury began to have concerns about the policy issues which were then under review in the Justice Department. However, in an effort to continue supporting the Service's position, we agreed to postpone any decision until we all had a chance to read the brief being prepared by the Solicitor General's office. About this time, I informed Fred Fielding, White House Counsel, of our growing concern about the case and the government's position. I later met with him in his office, on December 22, to explore the legal problems of the case, and indicated we were awaiting the Solicitor's brief supporting the Service.

Subsequently, on Monday, December 28, Secretary Regan informed me that Ed Meese wished to be apprised of the case. That afternoon I phoned Meese and told him that I was concerned about our position, that we had informed Fielding and that we all recognized the political sensitivity of taking a legal position that might be construed as contrary to the Administration's policy against racial discrimination. He pressed me to be sure that the Justice and Treasury Departments were absolutely comfortable with their position on the law before taking any action. I indicated that we were waiting for the final Justice Department draft brief supporting the IRS position before we made any decision.

On the evening of December 23, I read the initial Justice Department draft of the brief for the Supreme Court. The brief supported the IRS position that it had authority to deny the tax exemptions. I was unpersuaded by the logic or the legal citations. I then asked for a second draft brief narrowed to the issue of racial discrimination. However, the second draft, which I received on December 29, was still based on the theory that the Service could determine that certain Federal public policies could be used as a precondition for obtaining and retaining tax exempt status. Given two tries, there was apparently no legal theory that would permit the Service to deny tax exemptions on the basis of racial discrimination without also giving the authority to deny or revoke exemptions on other grounds.

I, therefore, concluded that the Treasury could no longer support the IRS on this matter, because the Government would be required to take a position in the Supreme Court that we simply did not regard as being either supported by statutory authority or adequately determined by the relevant case law and appropriate policy.

On December 30 the Deputy Attorney General, the Assistant Attorney General for Civil Rights and I met with Fred Fielding and others to tell Fielding of Treasury's preliminary decision. I talked to Secretary Regan in person on December 28 and by telephone on December 30. At no time during this process did either Fielding or Regan attempt to influence my judgment of the legal issues in the case or order me to reach any particular conclusion. I also had no contact with any Congressmen or Senators in making this decision.

In an effort to be certain that the Departments of Justice and Treasury were legally correct on a matter of such important national policy, we requested a one-week extension from the Supreme Court and reviewed the matter several times with the Commissioner and the Chief Counsel of IRS, the Treasury Department's Office of Tax Policy and with the Justice Department.

During this period, a number of the initial thoughts in our discussions were reduced to a draft memorandum by the Department of Justice -- the unsigned, undated copy of which has been furnished to this Committee -- and the final decision was made on January 8. This additional time permitted a thorough review of my decision by all the relevant senior officials in the Justice and Treasury Departments who might have a perspective on the case. By January 8 we were ready to announce our decision. Since we could not support the Service's position before the Supreme Court, there was no choice but to grant the tax exemptions which were the subject of the suit. I was out of Washington and by phone I directed the Commissioner of Internal Revenue to take the actions necessary to grant these exemptions. Since the case before the Supreme Court was now moot, the Justice Department filed a memorandum with the Supreme Court seeking to have the court vacate its jurisdiction.

RATIONALE FOR TREASURY DECISION

The decision announced on January 8, 1982, had its origins in a policy determination by the Nixon White House in 1970. That decision directed the Service to accede to the position of the plaintiffs in the first Green case in the Federal District Court. This reversed the long-standing IRS opposition to involving the administration of the tax laws in the controversy surrounding racial discrimination. Although this decision advanced a laudable goal, the 1970 decision was not soundly based on statutory law and the consequences of this expedient approach were finally recognized in late 1981 when the Treasury Department was required to approve the Justice Department brief which articulated the legal rationale adopted in 1970.

The Justice Department has prepared and delivered to the Treasury Department a memorandum of law which describes the legal deficiencies in the Service's position. As the Justice Department memorandum concludes, there is no adequate basis in law for the Service's position that it has the authority to select certain Federal public policies and impose these policies on tax exempt organizations. Nor is there a legal basis for concluding that the IRS has the statutory authority to invoke Section 501(c)(3) and the attendant denial of deductions under Section 170 to any school or university that violates the civil rights laws. The Justice Department memo makes clear that there is no statutory language or Congressional direction, no legislative history, and no definitive Supreme Court opinion, that authorizes or requires the IRS to revoke the tax exemptions of schools that do not comply with Federal public policy or otherwise violate the civil rights laws.

The Committee should note that there is no question that the Internal Revenue Service was under tremendous pressure to adopt the view it took in 1970, and has acted professionally and responsibly. However, the "public policies" rationale the Service adopted was a post hoc legal justification for a prior policy action.

In making the Treasury's policy decision we were faced with a classic moral dilemma. "Does the end justify the means?" That is, does the attainment of a good end or objective (eliminating discrimination) justify the endorsement of a theory that we regarded as unauthorized by law? This ethical dilemma has been long settled in all civilized societies. The answer is "no."

In addition, in the United States we have consistently adhered to the trite-sounding but immutable principle that we will have "a government of laws and not of men," and that is what this matter is all about. Should administrators and executives of the law be free to define "public policy" in the absence of legislative authority duly enacted by Congress? Again, the answer is "no."

The implications of continuing the policy of allowing the IRS to determine on its own those public policies denying tax exemptions was well stated by the district court in the Bob Jones case. There, the judge pointed out that Section 501(c)(3) does not endow the IRS with authority to discipline wrongdoers or to promote social change by denying exemptions to organizations that offend federal public policy. Voicing apprehension over such broad power, the district court observed: "Federal public policy is constantly changing. When can something be said to become federal public policy? Who decides? With a change of federal public policy, the law would change without congressional action -- a dilemma of constitutional proportions. Citizens could no longer rely on the law of Section 501(c)(3) as it is written, but would then rely on the IRS to tell them what it had decided the law to be for that particular day. Our laws would change at the whim of some nonelected IRS personnel, producing bureaucratic tyranny."

For example, if we were to endorse the theory on which the Service was proceeding before the Supreme Court, what would prevent the Service from revoking the tax exempt status of Smith College, a school open only to women? Does sex discrimination violate a clearly ennunciated public policy? Apparently someone in the state of Massachusetts thinks so, because litigation on this issue is currently going forward in the state courts of Massachusetts.

What about religious organizations that refuse to ordain priests of both sexes? And could the Commissioner decide that if Black Muslim organizations refuse to admit whites they should be denied a tax exempt status because they discriminate?

Further, should the IRS Commissioner be permitted -- in the absence of legislation -- to determine what is national policy on abortion? Should hospitals that refuse to perform abortions be denied their tax exempt status? Or, reading Federal policy another way, should hospitals that do perform abortions be denied their tax exempt status?

These extremely difficult but real issues illustrate the need for Congressional action on the question of tax exempt schools which discriminate on the basis of race. Here perhaps we have a national consensus which should be embodied in statute so that the Internal Revenue Service has appropriate guidance. To leave the judgment solely to the Service is not the responsible course.

It is simply because these issues are so difficult and fundamental to our society that they should not be left to an administrative determination by employees of the Federal Government, but rather should be determined by the elected representatives of the American people. It is for this reason that the Administration has developed and proposed the Administration's bill which is designed to give a clear Congressional mandate on these matters.

Thus the Administration urges the Congress to exercise its authority and responsibility to provide guidance on these matters so that there will be a basis in law to deny tax exempt status to educational institutions that discriminate on the basis of race.

DISCUSSION OF LEGISLATION

Finally, I turn to a description of the Administration's bill, which is before the Committee this morning. Section one of that bill directly addresses the issue before us. Specifically, a new Section 501(j) would be added to the Internal Revenue Code to deny 501(c)(3) treatment and 501(a) treatment if the school practices racial discrimination.

Failure to be described in Section 501(c)(3) also means that the organization is not within the exemptions from Federal social security and employment taxes provided in the Code. Correlative changes are made to the income, estate and gift tax deduction sections to provide that no deduction will be allowed for contributions to such organization.

The organizations covered are defined in new section 501(j)(1) to include those that maintain a regular faculty and curriculum and normally have a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. Generally, this is the same definition as appears in Code Section 170(b)(1)(A)(ii), and parallels the class of schools covered by the IRS's prior published procedures. Further, consistent with Rev. Rul. 75-231, the definition covers all organizations maintaining these schools.

New Code Section 501(j)(2) defines "racially discriminatory policy." Generally, under the bill, a school has such a policy if it refuses to admit students of all races (defined to include also color and national origin) to the rights, privileges, programs, and activities usually accorded or made available to students by that organization, or if the organization refuses to administer its educational policies, admissions policies, scholarship and loan programs, or other programs in a manner that does not discriminate on the basis of race. This definition generally conforms to that first established by the court in the Green litigation and carried forward by the IRS in Rev. Rul. 71-447 and subsequent pronouncements.

Additionally, Section 501(j)(2) contains an explicit provision in recognition of the legitimate interests of religious-based schools. Thus, under the bill, an admissions policy or a program of religious training or worship that is limited to, or grants preference or priority to, members of a particular religious organization or belief would not be considered a racially discriminatory policy. Thus, schools may confine admission and training to persons of a particular religion. The protection, however, will not apply if the policy, program, preference or priority is based upon race or upon a belief that requires discrimination on the basis of race. Pursuant to this rule, we expect that Bob Jones and Goldsboro would be denied their tax exempt status if they continue their past racial practices.

To ensure that the express congressional sanction does not grant a windfall to discriminatory schools and their contributors, previously denied the benefits of exemption, the legislation applies retroactively to July 10, 1970, the date the IRS first announced it would not grant exemption to private schools with discriminatory policies. We believe that a retroactive effective date is essential to preserve the national policy of denying tax exempt status to schools that racially discriminate, and that the retroactivity is constitutional.

Finally, the bill contemplates that present procedures regarding grant or denial of tax exemption will remain in place. Thus, a nonexempt organization must generally submit to the IRS an application requesting recognition of exemption, together with supporting material enabling the IRS to rule on all relevant issues, including racial discrimination. Organizations whose exemptions have been recognized will be subject to periodic examination to ensure continuing compliance with all applicable requirements.

If discrimination is found to exist, revocation will be proposed and advance assurance of deductibility of contributions will be suspended. Thereafter, the organization will be accorded substantial administrative appeal, including review by the National Office. If the finding of discrimination is sustained, exemption will be revoked and the organization, of course, has the opportunity to seek judicial review.

We have proposed this legislation to deal with the immediate need to empower the Internal Revenue Service with unmistakable authority to deny tax exemption to racially discriminatory schools. We recognize that it will not resolve the difficult definitional problems faced by the Internal Revenue Service in giving meaning to such general terms as "charitable" and "educational," and we invite further Congressional action to define better standards in those areas as well. We will, pending such action, continue to support the Internal Revenue Service in applying the 1959 regulations in the charitable area and in its efforts to deny exemption to those organizations engaged in illegal activities.

This concludes my testimony. I will be pleased to answer any questions you may have.

FOR IMMEDIATE RELEASE FEBRUARY 1, 1982

The Treasury announced today that the 2-1/2 year Treasury yield curve rate for the five business days ending February 1, 1982, averaged 14.55 % rounded to the nearest five basis points. Ceiling rates based on this rate will be in effect from Tuesday, February 2, 1982 through Tuesday, February 16, 1982.

Detailed rules as to the use of this rate in establishing the ceiling rates for small saver certificates were published in the Federal Register on July 17, 1981.

Small saver ceiling rates and related information is available from the DIDC on a recorded telephone message. The phone number is (202)566-3734.

Approved ______________________
Francis X. Cavanaugh
Acting Director
Office of Market Analysis
& Agency Finance

TREASURY NEWS
epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
February 1, 1982

CONTACT: Steven Hayes
202/566-2041

U.S. - Italian Certification Agreement Concerning Cuban Nickel

The Department of the Treasury announced today the conclusion of a formal certification agreement to ensure that nickel-bearing materials imported into the United States from Italy contain no Cuban nickel. Previously, imports of nickel-bearing materials from Italy were not permitted under the Treasury Department's Cuban Assets Control Regulations because Italian steel producers were using nickel of Cuban origin in their products. The United States has maintained a trade embargo against Cuba since 1962. The importation into the U.S. of Cuban products of raw materials, either directly or as components of products manufactured in other countries, is prohibited.

Under the certification agreement, signed January 6, 1982, the Government of Italy assumes responsibility for procedures under which it will issue certificates of origin certifying that exports to the United States from Italian steel-producing plants registered under the agreement contain no nickel of Cuban origin. Certificates of origin will be presented to U.S. Customs officials with the shipments at the time of importation. No shipment of nickel-bearing products from Italy will be permitted entry through Customs unless accompanied by such a certificate.

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R-595

NOTICE

DEPARTMENT OF THE TREASURY

Office of Foreign Assets Control

Issuance by Government of Italy of Certificate Verifying Non-Cuban Origin of Nickel-Bearing Materials; Importation From Italy of Nickel-Bearing Materials From Italian Companies

Certificates of origin are now available for importation from Italy of nickel-bearing materials and articles produced by Italian firms. These certificates are issued pursuant to a formal certification agreement between the Government of Italy and the Government of the United States. They will certify that the materials with respect to which the certificates are issued do not contain any nickel or nickel-oxide of Cuban origin. Each certificate will bear the following statement in the body of the document: "The Government of Italy hereby certifies that the products described herein do not contain nickel or nickel-oxide of Cuban origin. This cerificate has been granted in accordance with the procedures agreed upon by the Government of Italy and the Government of the United States on January 6, 1982."

Nickel-bearing materials may now be imported from Italy under the general license in §515.536 of the Regulations in accordance with the special certification provisions in that section and §515.808 of the Regulations. United States Customs entry will be permitted with respect to any such merchandise if either (1) a certificate of origin issued by the Government of

Italy (Ministero dell' Industria), or (2) a certification regarding interim shipments issued by the Government of Italy under paragraph F of the foregoing certification agreement, covering the particular merchandise to be imported, is presented to U.S. Customs authorities at the point of entry.

Dennis M. O'Connell

Dennis M. O'Connell
Director
Office of Foreign Assets Control

Dated: JAN 25 1982

TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE February 1, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $5,000 million of 13-week bills and for $5,002 million of 26-week bills, both to be issued on February 4, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 6, 1982			:	26-week bills maturing August 5, 1982		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.537 a/	13.700%	14.39%	:	93.049	13.749%	14.98%
Low	96.485	13.905%	14.61%	:	92.983	13.880%	15.13%
Average	96.499	13.850%	14.55%	:	93.000	13.846% 2/	15.10%

a/ Excepting 1 tender of $700,000.

Tenders at the low price for the 13-week bills were allotted 82%.
Tenders at the low price for the 26-week bills were allotted 90%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 62,790	$ 62,790	:	$ 105,575	$ 80,575
New York	7,650,290	3,649,290	:	8,333,000	3,621,740
Philadelphia	95,785	95,785	:	33,810	23,810
Cleveland	86,115	75,115	:	235,490	215,490
Richmond	72,865	66,685	:	108,175	68,175
Atlanta	79,460	78,460	:	65,045	58,565
Chicago	611,090	335,590	:	512,500	306,900
St. Louis	36,760	32,760	:	28,660	24,660
Minneapolis	14,985	14,985	:	22,565	22,565
Kansas City	60,675	60,675	:	66,075	65,810
Dallas	33,000	33,000	:	29,295	24,295
San Francisco	635,650	239,285	:	807,765	247,265
Treasury	255,615	255,615	:	241,715	241,715
TOTALS	$9,695,080	$5,000,035	:	$10,589,670	$5,001,565
Type					
Competitive	$7,400,345	$2,705,300	:	$ 7,974,025	$2,385,920
Noncompetitive	1,294,135	1,294,135	:	1,021,945	1,021,945
Subtotal, Public	$8,694,480	$3,999,435	:	$ 8,995,970	$3,407,865
Federal Reserve	794,700	794,700	:	750,000	750,000
Foreign Official Institutions	205,900	205,900	:	843,700	843,700
TOTALS	$9,695,080	$5,000,035	:	$10,589,670	$5,001,565

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 13.321%.

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TREASURY NEWS
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FOR RELEASE AFTER 1:00 P.M.
February 2, 1982

Remarks by
The Honorable Donald T. Regan
Secretary of the Treasury
To
The National Press Club
Washington, D.C.
Tuesday, February 2, 1982

It's been almost a year to the day since I last addressed the National Press Club. A lot of water has trickled under the bridge since then. A year ago I was accused of being a neophyte in the ways of Washington. Today, I may not know everything about maneuvering in this city. But I do know three things you can't do:

One -- don't make fun of Paul Volcker's cigars.

Two -- don't have breakfast with Bill Greider.

And three -- don't talk to the President about excise taxes.

You'll notice I didn't say anything about making speeches. I must have made more speeches, and talked with more reporters, in the last year than I did in my previous thirty-five at Merrill Lynch.

In a sense, I return to the Press Club today with the same vigor, and the same message, of a year ago. Last year I discussed our proposed economic recovery program. Now it is a fact. We are on a steadfast course of lower taxes, lower spending, less regulation and a stable monetary policy.

Not every aspect of the economy has gone the way we hoped. There have been variations in all of the economic indicators which at one point or another gave us cause for serious concern. But we know that we have a long term recovery program in place that will absorb the temporary nosedives or upsurges, and lead to permanent growth and stability. This resistance to stop and go policies that respond to every economic fluctuation is a major strength of our program. We are building a solid foundation for economic recovery -- first with the budget reductions last summer, then the tax rate reductions, and now the new Federalism.

It is a methodical implementation of the Reagan philosophy that our Federal government is too large; that our people should have a greater control over their own destiny; and that the people and their marketplace have the ultimate wisdom in allocating resources.

Many of the economic failures of the past stem directly from just the opposite philosophy: a federal government that absorbed more and more productive resources from the private sector; tax policies that penalized work, savings and investment; and monetary policies that alternately starved and force fed the economy.

The result was a sort of slow, strangulating death of economic productivity in this country. I describe it through a hypothesis with which many academic economists might disagree. Economists more or less arbitrarily have to establish certain definitions; a recession for example is defined as two successive quarters of decline in gross national product.

By classical economic criteria, therefore, there was a collapse in 1980, followed by a brief recovery. Then the current recession was declared in July of 1981. On the other hand, one could easily characterize the events of both years as a single period of recession.

Spread out on a graph, the various economic characteristics of both periods could be differentiated -- the positive from the negative -- and defensible distinctions made between the two. By the same token I'm sure that a cardiologist, studying the electrocardiogram of someone critically ill, could discern periods of normal and abnormal cardiac activity.

Nevertheless, he would not conclude that at one point the patient was healthy and, at another had suffered a relapse. The underlying pathology would be quite evident despite moments of normality -- the patient has a chronic problem.

And I suspect that most people in America define that problem as a lack of prosperity. It's an old word, sometimes discredited, but I think that's what people generally yearn for: prosperous times. They're not talking about inflationary times, or recessionary times, or stagflation.

And I want people to know that this Administration is trying to bring back a lasting prosperity to a strong and proud nation:

a time when people will know that hard work pays off, that savings and investment will lead to a higher standard of living, and that the rewards for risk-taking and innovation are real.

I know its difficult to talk of prosperity in a time of recession -- a time when auto workers are laid off in droves; when homes can't be sold, bought or built; and money is scarce. But now <u>is</u> the time to talk about it.

Now is the time to say: here's what's ahead

In July we get a tax cut of $32 billion -- ten percent more of your own money staying in your own pocketbook. Thanks to a tax cut already in place -- not one that comes too late.

Millions of Americans will also get a boost in their Social Security checks in July -- $16 billion to spend or save at a time when inflation will be between 7 and 8 percent, instead of between 12 and 13 percent.

The path of our leading indicators is changing: September down 1.7 percent; October down 1.8 percent, November down .2 percent, and now December <u>up</u> .6 percent.

We have achieved substantial reduction in the growth of federal spending. Spending had been rising at 13 percent per year under the Carter budgets through FY 1981. The spending reductions already enacted and those still to be proposed, coupled with faster economic growth, will bring us closer to our long term goals of 19 to 20 percent of GNP in the years ahead.

The Economic Recovery Tax Act of 1981 is in place. The accelerated cost recovery system increases the investment tax credit, and shortens and simplifies the depreciation schedules. It will restore a reasonable rate of return on investment in plant and equipment. For the first time in years, firms will be allowed a tax write off large enough to let them modernize their plant and equipment, the costs of which have been rising sharply with inflation.

Personal tax rate reductions of nearly 25 percent over three years will keep workers and savers ahead of bracket creep, until the tax code is finally indexed in 1985. Under the three year incentive tax rate reduction, after tax wages, interest and dividends will rise. The cost of hiring and borrowing will fall. The bracket creep which had discouraged U.S. labor, and priced it increasingly out of world markets, is at an end. The rising marginal tax rates which, with inflation, have cut personal savings rates in all brackets almost in half between 1975 and 1980, will be reduced. Discriminatory tax rates on income from saving have been ended, and the marriage penalty has been reduced.

These policies are just beginning. It will take time for them to work. The public understands this. Polls indicate that the people believe the economic recovery program will turn the economy around, and that they are willing to give it time to work.

In fact, there are signs of progress already:

Consumer prices, which rose 12.4 percent during 1980, rose just under 9 percent in 1981, and will continue to slow in the months ahead.

Producer prices, which rose 11.8 percent during 1980, rose only 7.0 percent in 1981, and indicate continued moderation at the consumer level.

Interest rates, driven by inflation, reached record highs in the last two years, but have since fallen. The prime rate was 21-1/2 percent a year ago. It was down to 15 3/4, then yesterday Citibank jumped the rate up to 16 1/2 percent. That's discouraging but not unexpected. Recessionary history indicates that interest rates often bounce briefly higher once a recovery starts, and then they decline. I believe we'll see the same pattern this time.

We have already seen a dramatic drop in the inflation rate. A year ago I told this group that fighting inflation was our number one priority. Last February the inflation rate was 11.3 percent. Today it is 8.9 percent.

Today I can say that keeping inflation down, and bringing interest rates down with it, constitute our number one priority. That's one reason why there has been so much attention paid to monetary policy in recent weeks -- and so much misintrepretation of my position.

Monetary policy is a complex issue, but perhaps some simpler explanations are possible. Last week I spent nearly an hour with a reporter dissecting every number, letter, word, vowel and comma ever uttered about the Federal Reserve Board. I finished exhausted, and convinced that the whole exercise was slightly irrelevant to the concerns of the American people.

So let me try this one:

All I want from the Fed is enough money to buy an ever increasing amount of goods. In the vernacular of government that means a slow, steady growth in money supply.

I also believe that the Fed shares this view and wants to smooth out the recent erratic behavior in the money supply.

The other big question I get concerns whether or not the deficits will choke off the recovery. My answer is no.

Those deficits will be financed by economic growth and increased savings -- growth stimulated by the Economic Recovery Tax Act, and by further reductions in government spending -- reductions that make resources available to the private, productive sector of the economy.

Economic growth and responsible federal spending are the only truly effective means of ultimately balancing the budget. To try to do so by tampering with the tax program would simply provide more money to support government growth at the expense of the private sector.

Real economic growth will reduce the weight of the deficits -- a weight that in other circumstances might prove onerous.

Increased savings will accommodate the credit needs of both government and private borrowers. We estimate that private savings in 1984 will exceed those of last year by $250 billion -- a quarter of a trillion dollars.

Having said that, let me repeat a concern that I've expressed in the past: deficits matter to this Administration. First, because we want the budget balanced; and second, because we want Federal spending smaller as a percent of GNP. They also matter because they signify the pervasive intrusion of government into the private affairs of Americans.

And because of that concern, our new budget projections will show deficits decreasing annually well below the $100 billion mark. We're through trying to increase revenues so they can be spent.

And I don't have much patience for the born again budget balancers in the Congress who created these deficits in the first place.

The Democratic leadership has responded to our proposals with chest beating, brow raising and empty posturing.

Their only hope is for a failure of our program.

Their only alternative is higher taxes and greater spending.

For years the Democrats threw billions of dollars and bundles of bureaucrats at every problem they could identify. Now they wonder why its so hard to get deficits down.

The President will propose $63 billion in new entitlement reforms over the next four years. He's going to send up a FY 83 budget that will give the Democratic deficit fighters a chance to show their stuff. I honestly hope they are up to the tough choices ahead.

The Administration is also proposing changes in the tax code similar to those the President suggested last September. We hope Congress will adopt those changes. By eliminating a number of provisions that are now obsolete and some that are unjustified, we'll raise more than $30 billion in the next two years.

Perhaps most unjustified are provisions of the tax code that allow profitable corporations to pay little regular income tax. No company should be exempt from shouldering a fair share.

Similarly, we will propose to repeal business energy tax credits, restrict tax exempt bonds, and close several other loopholes in the tax code.

We also want to tighten up on the collection of taxes. This includes more IRS agents and better collection procedures. It includes a proposal to withhold five percent of the tax on interest and dividends. I realize that this proposal has not been very popular in the past. But we're going to give the public full opportunity to comment on its merits.

Bear in mind: these changes in the tax laws are consistent with the tax incentives enacted last year; they will not undermine them.

All of this leads me to take a brief look down the road. I try to avoid forecasts as much as possible. For one thing, forecasting has a high vanity factor, much like the young woman who went to her priest and confessed to that very sin.

"Every morning I look in the mirror," she told the Father, "and I think how beautiful I am."

The voice in the confessional replied, "Don't be alarmed my dear. That's not a sin. It's a mistake."

Forecasting can lead to some sinful mistakes. But I would like to share a little recession history with you that shows why I am encouraged about the future.

In the final three months of the 1969-70 recession real GNP fell at a 3.1 percent annual rate and then soared at a 10.3 percent rate in the first recovery quarter.

In the last quarter of the 1973-75 slump the GNP measure fell 8.2 percent annually and then rose at 5.0 percent and 9.3 percent rates in the next two quarters.

And never has there been a program like ours already in place during recession to spur the economic recovery. I think the economy is going to come roaring back in the late spring. I think we will see recovery in the stock market and home building and I think we will see continuing relief on inflation and interest rates.

But I want to be firm in saying: the one thing that would surely stop recovery now is for Congress to renege on the tax cuts or to increase spending.

It is with this sense of confidence that the President proposed initiatives for a new Federalism.

This Administration is committed wholeheartedly to returning authority and responsibility to the states. As a first step, we took fifty-seven categorical programs and combined them into nine new block grants with budget authority of more than $7.5 billion.

We will propose a return of over 40 Federal programs to state and local governments--governments which have gone through significant innovation and reform in recent years.

We intend to create a bridge to a time when state and local governments will resume the responsibilities that are rightfully theirs, along with the resources to carry out those responsibilities.

The "New Federalism", as well as every other domestic measure that the President proposed in his State of the Union message, is molded by a philosophical consistency that has not been seen in Washington in years. Its unifying principle is the belief that each level of government should assume only those responsibilities that cannot be carried out at a lower level. Ideally, we want to see as much responsibility as possible carried out not by government, but by individuals, cooperating voluntarily in the private sector.

That's what such proposals as enterprise zones have sought to do: return resources to individuals operating in the private sector -- individuals who will use those resources to promote solid, long-term growth.

Likewise, the New Federalism is a logical extension of that effort. We're returning to the states the responsibilities and resources to perform functions that were usurped by the federal government.

I can't think of a better way to conclude my remarks than to quote from President Reagan's message:

"Don't let anyone tell you that America's best days are behind her -- that the American spirit has been vanquished. We've seen it triumph too often in our lives to stop believing in it now."

The seeds of recovery and long term growth have been planted.

The foundation for prosperity has been laid.

We are moving inexorably toward that goal.

Thank you.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. February 2, 1982

TREASURY ANNOUNCES WEEKLY BILL OFFERING AND CHANGE IN DATE OF THE FOLLOWING WEEK'S AUCTIONS.

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $10,000 million, to be issued February 11, 1982. This offering will provide $900 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $9,088 million, including $1,229 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,707 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 $5,000 million, representing an additional amount of bills dated November 12, 1981, and to mature May 13, 1982 (CUSIP No. 912794 AQ 7), currently outstanding in the amount of $4,734 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $5,000 million, representing an additional amount of bills dated August 13, 1981, and to mature August 12, 1982 (CUSIP No. 912794 AX 2), currently outstanding in the amount of $4,512 million, the additional and original bills to be freely interchangeable.

The bills announced today will be auctioned on Monday, February 8, 1982. However, due to a combination of Federal and local holidays on February 12 and February 15, 1982, Treasury's next weekly bill auctions will be held on Tuesday, February 16, 1982. Details concerning this offering will be announced, as usual, on Tuesday, February 9, 1982.

Both series of bills will be issued for cash and in exchange for Treasury bills maturing February 11, 1982. Tenders from Federal Reserve Banks for themselves and as agents for 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 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. 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.

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Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, February 8, 1982. 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 as of 12:30 p.m. Eastern time on the day of 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 February 11, 1982, in cash or other immediately-available funds or in Treasury bills maturing February 11, 1982. 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 Section 454(b) of the Internal Revenue Code, the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed, or otherwise disposed of. Section 1232(a)(4) provides that any gain on the sale or redemption of these bills that does not exceed the ratable share of the acquisition discount must be included in the Federal income tax return of the owner as ordinary income. The acquisition discount is the excess of the stated redemption price over the taxpayer's basis (cost) for the bill. The ratable share of this discount is determined by multiplying such discount by a fraction, the numerator of which is the number of days the taxpayer held the bill and the denominator of which is the number of days from the day following the taxpayer's date of purchase to the maturity of the bill. If the gain on the sale of a bill exceeds the taxpayer's ratable portion of the acquisition discount, the excess gain is treated as short-term capital gain.

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.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE February 2, 1982

RESULTS OF AUCTION OF 3-YEAR NOTES

The Department of the Treasury has accepted \$5,005 million of \$10,516 million of tenders received from the public for the 3-year notes, Series L-1985, auctioned today. The notes will be issued February 16, 1982, and mature February 15, 1985.

The interest coupon rate on the notes will be 14-5/8%. The range of accepted competitive bids, and the corresponding prices at the 14-5/8% coupon rate are as follows:

	Bids	Prices
Lowest yield	14.57%	100.130
Highest yield	14.67%	99.894
Average yield	14.63%	99.988

Tenders at the high yield were allotted 30%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

	Received	Accepted
Boston	\$ 56,285	\$ 48,285
New York	8,457,760	3,958,800
Philadelphia	37,000	31,000
Cleveland	96,250	69,250
Richmond	108,150	51,130
Atlanta	104,840	83,040
Chicago	727,395	237,090
St. Louis	107,440	101,840
Minneapolis	52,050	44,850
Kansas City	115,450	111,940
Dallas	46,595	34,695
San Francisco	602,535	228,630
Treasury	4,400	4,375
Totals	\$10,516,150	\$5,004,925

The \$5,005 million of accepted tenders includes \$1,353 million of noncompetitive tenders and \$3,474 million of competitive tenders from private investors. It also includes \$178 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 \$5,005 million of tenders accepted in the auction process, \$275 million of tenders were accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities, and \$527 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

R-5·9

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE UPON DELIVERY

ADDRESS BY
THE HONORABLE JOHN M. WALKER, JR.
ASSISTANT SECRETARY (ENFORCEMENT AND OPERATIONS)
U.S. TREASURY DEPARTMENT
BEFORE THE
NINTH ANNUAL CONFERENCE
OF THE
DISTILLED SPIRITS COUNCIL OF THE UNITED STATES, INC.
IN
PHOENIX, ARIZONA
ON
WEDNESDAY, JANUARY 27, 1982

I am pleased to have been invited today to address this Ninth Annual Conference of the Distilled Spirits Council of the United States.

And, I believe, it is a great opportunity as well, because it gives me, as a representative of the Treasury and the Reagan Administration, a chance not only to speak to you directly, but also to hear your concerns first hand.

I have learned in my first year in office that the concerns that you have raised with the government are many and varied with far-reaching implications for your industry.

I am reminded of an example of how a seemingly straight-forward matter can have long-term ramifications by a story about Moses when he returned from the mountain top where he had received the word of God.

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The Israelites were gathered by the thousands at the foot of the mountain where Moses descended clutching the two tablets containing the Commandments of God.

Moses said to them: "There is good news and there is bad news." The good news is that I got Him down to ten. The bad news is that the regulations are not out yet."

While I will not go so far as to equate the reform of the Federal Alcohol Administration Act with the announcement of the Ten Commandments, I am aware that such reform as well as the resolution of other issues for your industry will have long-term effects.

We are not always on the same sides of an issue, sometimes our disagreements are profound. Yet the Treasury Department and the distilled spirits industry have had an unusually close relationship over many years, longer than the lifetimes of many of us in this room. Your views will always have a receptive ear at Treasury. And, whatever our differences, please be assured that we at Treasury have an interest in the future and well-being of your industry that transcends mere preservation of a valuable source of tax revenues.

At Treasury, we want to see -

- o high standards of quality maintenance for your product;
- o the integrity of your labels protected from unscrupulous operators who would destroy the reputation of your products among consumers;
- o a robust export market for American distilled spirits, beer, and wine;
- o the continuation of your voluntary efforts to provide useful information to the public on hazards of immoderate drinking in a rational, non-emotional context.

Having stated these common objectives, I want to discuss with you the pending issues between us that are of importance to your industry.

Anti-Alcoholism Efforts/Health Warning Label

An area of agreement between us is our common belief that government and industry must continue to respond to concerns over the effects of immoderate drinking on pregnant women. The problem is primarily one of education, of providing information to expectant mothers by the most effective means possible. Treasury favors industry's voluntary effort to inform expectant mothers through the Beverage Alcohol Information Council.

Of course, you must take this job seriously, because if it appears that your efforts are not succeeding, or that you are confining your campaign to a few little-read "baby" magazines, there will be mounting pressure for a so-called "health warning label" of the kind now required on cigarette packages and products containing saccharin. And Treasury will be required to consider seriously the health warning label alternative.

With regard to the related alcohol abuse problem of drunken driving, it is not so much a matter of public education. There is universal awareness that one who is intoxicated should not drive an automobile. Rather, the problem is to alter attitudes -- so that when people drink too much they will admit it to themselves and to their friends, and refrain from driving. Or in situations where they cannot avoid driving they will avoid drinking altogether, or drink only in great moderation. I have seen some of your advertisements aimed at getting this message across, and I believe that this approach, if pursued vigorously, will be effective. Clearly, this is an effort in which we wish you success.

Need to Expand Exports

Another area in which Treasury and the distilled spirits industry can work together is in the expansion of export sales. In calendar year 1971 the value of distilled spirits exports amounted to about $23 million. Although final figures for 1981 are not yet in, it appears that 1981 exports will be around $70 million. While this may be a nice increase in relative terms, in absolute terms, it is only an increase of $47 million in U.S. export sales of distilled spirits over an entire decade. And even this increase would be diminished if adjusted for inflation. Moreover, when exports of $70 million are seen against a background of total domestic industry sales of $19.3 billion! there isn't much to crow about.

During the same decade, your foreign competitors have not been idle. U.S. imports of distilled spirits have increased from $621 million in 1971 to approximatley $1.1 or $1.2 billion in 1981. The increase in imports, then, is 10 to 12 times the increase in exports.

We need to export more. This is an area in which we must work together. Government's task is to address the trade barriers which foreign countries erect to block the sale of U.S. alcoholic beverages - both tariff and non-tariff - particularly the latter. And this can be done. We have, within a fairly short time, won some significant concessions in our consultations with the European Community on wine trade. This is no reason to think that similar gains cannot be made in trade in distilled spirits, and with your support, we are ready to try.

But you must hold up your end. You must actively promote your products in promising markets, even though the initial returns may be low. I continually hear that overseas markets are not worthwhile because of low incomes, or because foreign palates have not developed a taste for our distilled spirits, or because in warm climates people prefer light, cool, refreshing drinks. I am not persuaded.

In fact, per capita incomes in the industrialized countries of Europe and in Japan have long been high enough to make these markets promising, and incomes can be expected to rise in those developing countries which are so successfully taking over many of the world's manufacturing jobs.

As for the notion that foreigners have no taste for American bourbon whiskey, for example, we should remember that not too long ago there was no market in this country for vodka, nor a substantial market for table wine. These markets had to be developed, and for those who were willing to make the investment, the rewards have been handsome.

Finally, to those who say that American distilled spirits are too "heavy" to be marketed in temperate climates, what better rebuttal can be offered than our own mint julep, or any of the drinks made with American gin or vodka.

But all of these markets must be developed. I don't need to tell you that growth prospects are not good for distilled spirits producers who limit themselves to the U.S. market. And, of course, I don't need to remind you that distilled spirits bottled for export are not subject to the federal excise tax on alcohol.

ATF Reorganization

Let me turn for a minute to another matter that is of utmost importance to your industry - our plan to reorganize the Bureau of Alcohol, Tobacco and Firearms. This reorganization is partly prompted by budgetary restrictions, but quite apart from that, it makes good sense.

For some time it has been recognized that ATF combines an anomalous set of functions with different constituencies.

In the same bureau:

-- there is a criminal enforcement mission directed at the most violent kinds of crime: illegal trafficking in firearms and explosives, and arson;

-- there is a revenue protection mission of the sort traditionally operated in Treasury; and

-- there is a regulatory mission, very much like those conducted by the Food and Drug Administration, and the Federal Trade Commission.

We believe that these missions can be carried out at less cost, and an improvement in effectiveness, if we separate them and transfer them to Treasury bureaus which have similar or related missions. Our plan, then, is to transfer the criminal enforcement functions of ATF to the Secret Service, and the revenue protection and regulatory missions to the Customs Service.

This reorganization is of paramount importance, not only to Treasury but to this Administration.

The transfer of ATF special agents to the Secret Service will enhance the Service's ability to protect the President, the Vice-President and other officials and at the same time enable us to intensify our efforts against criminal trafficking in firearms, and the other dangerous crimes which fall under ATF's investigative jurisdiction.

We believe that the transfer of alcohol and tobacco functions to the Customs Service will benefit your industry. Your relationship with government will no longer be affected by interest groups surrounding the firearm controversy unrelated to your industry. Your industry will be in the hands of an agency, the U.S. Customs Service, that is familiar with matters of commerce and trade and will be given high visibility within that agency -- at the Assistant Commissioner level if our plan is implemented. The responsibility of my office - at the Assistant Secretary level - will not be changed.

I have discussed with Fred Meister and Jeff Peterson the importance we attach to getting this reorganization through, and I want to emphasize to you that this is a matter of top priority for my office.

Budget

In order to accommodate to the budget allowances given us for fiscal years 1982 and 1983 we have had to propose substantial reductions in Treasury programs, including the Office of the Secretary, and including ATF.

Here again we had stark options. We could not take major reductions in ATF's criminal enforcement programs, not only because it would totally preclude carrying out our planned transfer of special agents to the Secret Service, but also because a major reduction in this area would cut against President Reagan's commitment to strong law enforcement.

We could not, we believed, make further reductions to the revenue protection program without jeopardizing revenues. Over the last two years, as ATF has converted from the joint custody system to the all-in-bond system, there have already been substantial reductions in the inspector workforce. The all-in-bond system is clearly more efficient but it is largely untested, and in our judgment further reductions would be unwise.

Ultimately we chose the third option: curtailing enforcement of the 1935 Federal Alcohol Administration Act.

Let me say two things about this decision. First, based upon its actions in passing the Continuing Resolution, I recognize the distinct possibility that Congress may restore funds to continue the FAA Act programs. If this is done, we shall, of course, continue the function. But second - we believe - and I know that many of you believe - that the level of federal regulation called for by the FAA Act, with its criminal penalties and stringent restrictions on trade practices, is unwarranted. It is the product of an obsolete, pre-prohibition attitude toward the alcoholic beverage industry, and is long overdue for a major overhaul whatever the funding level for its enforcement.

FAA Act Amendments

For some time now my staff and representatives of your industry have been discussing a draft bill to revise the FAA Act which we intend to submit to Congress in the near future. Although we have not yet circulated our draft bill to other departments for comment, it is my view that the role of the federal government in the alcoholic beverage industry, like other industries, ought to be strictly circumscribed.

Let me describe briefly some of the changes we are considering which are of most interest to you, with the caveat that we have not yet had an opportunity to discuss these changes within the Administration and to get the approval of other interested agencies.

Penalty System

First, the current system of sanctions, consisting of threats of misdemeanor prosecution, offers in compromise, and threats of suspension or revocation of permits, does not afford us a system of graduated, flexible penalties for violations of the law.

It is simply not practical for us to undertake a criminal prosecution for each and every violation of the law, no matter how minor, nor is it practical in most cases to suspend, even for a short time, your permit to operate. Not only are these penalties cumbersome to administer, but each has an effect that lasts long after the practices which gave rise to the penalty action are corrected. In one case, you are left with the stigma of having been criminally prosecuted, and perhaps convicted for a minor transgression, by the Federal government; in the other case, you have hanging over your head, indefinitely, the possibility of permit revocation. Although the possibility of permit revocation is extremely remote, nevertheless, it is sufficiently frightening to prospective lenders that it may impair your ability to borrow money.

We would propose to eliminate the provisions of law which authorize permit suspension or revocation. Present qualification requirements would continue as before, but once issued the permit could not be revoked except for a a very narrow basis, such as fraud in the application.

In place of permit suspension and revocaton, we would envision a system of administration penalties, with an opportunity given you for administrative appeal, and access to the federal courts if necessary. A system like this has been in place in the U.S. Customs Service for many years and has proved to be fair, flexible, and efficient.

Deregulation

Another proposed change I would like to highlight is in the controversial trade practice area. First, we want to reduce substantially the range of business practices prohibited by the FAA Act. Secondly, we want to eliminate present uncertainties over whether a particular business practice violates the law.

Of course, I am aware that there are differences between alcoholic beverages and other consumer products:

- they are sensitive and, when abused, dangerous products;

- they are regulated or controlled by the states often in different ways;

- retail outlets are often restricted in a given community.

I understand that alcoholic beverages cannot be marketed like soft drinks.

But I also strongly believe that the result of many of the Act's prohibitions and restrictions on trade practices is to prevent or restrain normal competition as to marketing of alcoholic beverages. These prohibitions were conceived in the early 1930's following prohibition when the Fair Code of Competition for this industry was made part of the National Industrial Recovery Act. In 1935 they were incorporated into Section 205 of the FAA Act.

The prohibitions were targeted at practices which dated back to the turn of the century when the cultural and business climates of this country were different. They go far beyond what is necessary to prevent predatory competition or formation of a monopoly. They also prevent activities which are normal business practices today, such as sales contests, joint promotional campaigns, and other more sophisticated marketing techniques -- activities which are in no sense sinister or harmful to the public interest.

I might note that we in Treasury are not alone in believing that the time for reform is at hand, nor does support for reform come only from the big operators who, some fear, will force everyone else out of business. Just recently Secretary Regan received a letter from the owner of a small winery in California. Let me read to you a part of this letter:

> "Dear Secretary Regan:
>
> "Bravo on deregulation of our wine industry. I am one hundred percent for it.
>
> *******
>
> "I urge you to carry on. Deregulate us completely. Let the free market control us far more effectively and efficiently than any group of even well-meaning bureaucrats could ever do. When the smoke clears, our industry will be grateful! We will find, as other industries have found, that we are not subject to chaotic control by the individual states and that we are far more successful as an industry in serving the public."

Finally, there is one other change we have in mind -- a change which was recommended to us by the National Beer Wholesalers Association. This would provide for a right of action by private parties who can show that they have suffered economic injury as a result of their competitors having violated the FAA Act. This would be similar to the the private right of action presently available to injured parties under the anti-trust laws. As you are aware, injured competitors may sue for three times the damages suffered under the anti-trust laws.

We are favorably disposed toward this idea. It is consistent with the proposal Secretary Regan made to representatives of the alcoholic beverage industry in late October when he suggested that you consider a greater degree of self-regulation. It also recognizes that the budget limitations will restrict the extent to which Treasury can enforce the FAA Act. If the law can be written to discourage nuisance suits, as we believe it can, the right to private action would greatly enhance our joint effort, yours and ours, to ensure that there is an orderly and competitive market for alcoholic beverages in this country.

Let me close by thanking you for having me here today. I look forward to working with you. You will always find an open door at Treasury when you have problems on which we can be helpful, and, although we may not decide every issue as you would like, I hope you will say of us that we are both reasonable and fair.

Thank you very much.

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