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T: PRESS RELEASES

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
Friday, March 5, 1982

There were no injuries and only limited damage from a fire at the Bureau of Engraving and Printing this morning. The fire, of undetermined cause, apparently started in duct work in a pressroom devoted to postage stamp printing. It was discovered at approximately 2:45 a.m. and, aided by automatic extinguishers, employees at the scene contained the fire until D.C. firemen arrived and brought it under complete control by 4:00 a.m.

The fire was confined to a 4,000 square foot wing of the Bureau's Annex Building, east of 14th at C Street. Two of the four printing presses in the area are expected to be in operation next week, and the two others will require refurbishment. It is expected that some stretchout in scheduled delivery of selected postage stamps will be required, but rearrangement of production schedules will result in minimal impact on the overall Postal Service product program.

Cost of repairing the damage has not yet been determined in detail, but is not expected to exceed $75,000.

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TREASURY NEWS

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

March 5, 1982

BIOGRAPHICAL NOTES

ANN DORE MCLAUGHLIN
ASSISTANT SECRETARY FOR PUBLIC AFFAIRS

Ann Dore McLaughlin was confirmed on June 12, 1981 as Assistant Secretary of the Treasury for Public Affairs.

Since 1977 Mrs. McLaughlin has been President of McLaughlin & Company of Washington, D.C. and Washington Manager of Braun and Company of Los Angeles, California. Both firms are public affairs companies.

In 1974-77 she was with the Union Carbide Corporation. She was director, Office of Public Affairs, Environmental Protection Agency, in 1973-74. Mrs. McLaughlin was Assistant to the Chairman and Press Secretary, Presidential Inaugural Committee in 1972-73. In 1971-72 she was Director of Communications, Presidential Election Committee. Previously she served as an Account Executive with Myers-Infoplan International, Inc. of New York City. Mrs. McLaughlin was Director, Alumnae Relations, Marymount College in 1966-69; and Supervisor, Network Commercial Scheduling, American Broadcasting Company, in 1963-66.

Mrs. McLaughlin was graduated from Marymount College (B.A., 1963) and attended the University of London, Queen Mary College in 1961-62.

Mrs. McLaughlin is married and resides in Washington, D.C. She was born in Chatham, New Jersey on November 16, 1941.

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TREASURY NEWS

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March 8, 1982

BIOGRAPHY

Michael A. Driggs
Acting Director of the Office of Chrysler Finance

Michael A. Driggs is currently the Executive Director of the Chrysler Corporation Loan Guarantee Board and the acting Director of the Office of Chrysler Finance for the Office of the Secretary. The Office of Chrysler Finance is responsible for supporting the activities of the Chrysler Corporation Loan Guarantee Board, which has the authority to guarantee up to $1.5 billion in loans to the Chrysler Corporation. He has been in the Office since its inception in January 1980.

Previously, he was with the Office of Management and Budget from 1973 through 1979. He was responsible for review of federal transportation activities concentrating on the railroad industry. His first three years at OMB were spent in review of the activities of several foreign intelligence agencies.

He was an intelligence officer in the United States Army from 1969 to 1972. He had several assignments in the United States and the Republic of Viet Nam.

Mr. Driggs has an MPA and BA degree from the University of West Virginia. He is single and resides in Washington, D.C.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE March 8, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $4,802 million of 13-week bills and for $4,802 million of 26-week bills, both to be issued on March 11, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 10, 1982			26-week bills maturing September 9, 1982		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	96.967 a/	11.999%	12.55%	93.947 b/	11.973%	12.92%
Low	96.942	12.098%	12.65%	93.885	12.096%	13.06%
Average	96.952	12.058%	12.61%	93.901	12.064% 2/	13.03%

a/ Excepting 5 tenders totaling $4,100,000.
b/ Excepting 3 tenders totaling $3,000,000.

Tenders at the low price for the 13-week bills were allotted 33%.
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	$ 66,425	$ 50,345	$ 107,310	$ 77,310
New York	8,318,100	3,692,900	7,225,930	3,637,330
Philadelphia	82,065	32,065	22,580	22,580
Cleveland	65,415	44,415	59,585	49,585
Richmond	43,245	43,245	112,530	97,530
Atlanta	55,300	54,550	76,625	75,625
Chicago	776,255	374,505	710,110	288,510
St. Louis	33,535	32,535	41,025	31,725
Minneapolis	20,985	18,975	42,840	39,840
Kansas City	55,025	55,025	43,675	43,675
Dallas	29,105	25,755	22,060	17,060
San Francisco	544,365	151,415	637,930	148,930
Treasury	225,855	225,855	272,550	272,540
TOTALS	$10,315,675	$4,801,585	$9,374,750	$4,802,240
Type				
Competitive	$ 8,165,080	$2,750,990	$6,816,520	$2,344,010
Noncompetitive	1,054,295	1,054,295	980,730	980,730
Subtotal, Public	$ 9,219,375	$3,805,285	$7,797,250	$3,324,740
Federal Reserve	1,080,100	980,100	975,000	875,000
Foreign Official Institutions	16,200	16,200	602,500	602,500
TOTALS	$10,315,675	$4,801,585	$9,374,750	$4,802,240

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.976%.

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TREASURY NEWS

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

For Immediate Release:
March 9, 1982

Remarks Prepared For Delivery By
The Honorable Donald T. Regan
Secretary of The Treasury
To
The Chamber of Commerce
Winston Salem, North Carolina
Tuesday, March 9, 1982

I am delighted to be here in North Carolina -- a state with a long and glorious history. Through the years North Carolina has given many a prominent son and daughter to the service of the United States -- not least among them are Senators Jesse Helms and John East.

This state has a gift for producing talented people -- just ask any Virginian and they'll tell you about the talents of Sam Perkins, James Worthy and Dean Smith.

Most of us here have studied at least some history. And most have probably found it a collection of dry facts and cold, dispassionate analysis.

However, if one were to trace the development of that discipline to its origins, one would find that history was intermingled with mythology. The ancient Greek historian Herodotus is a case in point: Confronted with an event that he could not interpret, Herodotus and other ancient historians simply resorted to a myth in order to explain it.

I mention this only because today there are some who would use the same technique to impugn this Administration's policies and purposes. The confusion of myth and reality may have been harmless in the ancient world; but in these times the consequences of that confusion can be profound indeed.

I'm afraid that myths about the Administration's program are concocted daily, and communicated instantaneously. I'd like to spend some time today examining some of those myths to see if there is any element of truth in them, or whether reality is so far divorced from myth as to leave them empty slogans -- mere propaganda in the service of politics-as-usual.

The first myth is that things were better just a few years ago and we should return to those wonderful days of a high inflation economy.

For those of you who have forgotten the joys of 13 percent inflation and 21 percent interest rates, it must be reassuring to hear that ghostly call from our opponents for easy money,

quick-fix tax increases, and less defense spending.

As former Vice President Mondale assumes the mantel of economic spokesman, we can almost see the current Democratic leadership in the Congress feeding him talking points on the glories of past policies -- the policies of failure that got us into this mess in the first place.

It was during the Carter Administration that inflation and interest rates reached all time highs: that the market for housing and autos started their trek to all-time lows. I suggest we ask the unemployed if they want a return to those policies. I suggest we ask the Ford Motor Company employees who just ageeed to pay cuts in order to save their jobs if they also want new tax increases and a return to higher inflation.

Those are the people in the front lines of this fight for economic recovery. And they know better than to believe the myths of the gloomocrats who shout depression and hope for a failure of our program.

The second myth is: "Reaganomics has been tried and found wanting." Reality, however, says otherwise. To paraphrase the English author G.K. Chesterton: The Administration's program has been found difficult, and has not yet been fully tried.

Let me just remind you of how the program was fashioned in the first place. Shortly after the Administration took office, a carefully integrated economic game plan was developed.

Simply stated, it was a fourfold program: first, we asked for an across-the-board tax cut of thirty percent over three years; second, we asked for major cuts in the fiscal 1982 budget; third, we instituted a program of regulatory reform; and fourth, we encouraged the Federal Reserve Board in a policy of slow, steady growth in the money supply -- one that did not alternately starve and force feed the economy.

Only one element of the program is fully operative. Regulatory reform is being carried out under the auspices of Vice President Bush. It's been remarkably successful so far, saving the private sector $2 billion in annual operating costs, and perhaps $5 billion in initial capital costs.

Other parts of the program are only partially operative. Accelerated cost recovery for capital investments went into effect last year. All told American business will realize an increase of around $10 billion in cash flow in 1982 alone. That's $10 billion that American businesses won't be dipping into the credit markets for.

The thirty percent across-the-board personal tax reductions that we originally proposed were reduced and delayed by the Congress. Last year's five percent cut, coming as it did in the

fourth quarter, was only 1.25 percent for the year, and was swallowed whole by inflation.

The truly significant cuts won't begin until this July when personal tax rates will be cut by ten percent. I might add that this will be the first time in recent history that a tax cut has become effective during a recovery rather than later, as was so often the case in the past.

July's cut will be followed next year by an additional ten percent rate cut, making the cumulative cut in tax rates twenty-five percent.

The Administration's advocacy of slower growth in the money supply brought results even beyond our expectations. In 1980, the annual inflation rate was 12.4 percent. In January of this year it was down to 8.4 percent, and in the previous four months it was running at an even lower rate.

The fourth element in our program was a reduction in the growth of federal spending. As a result of bipartisan efforts we were able to cut $35 billion from the fiscal 1982 budget.

The program still is sufficient to put the United States back on the road to real, noninflationary growth. If Congress will give it the time, the program will work; if Congress will cooperate with the Administration's latest economic proposals, the program will lead us out of this recession and onto the economic high ground of prosperity.

The third myth that we find circulating goes something like this: When the Federal government dips into the credit market to finance the deficit, it will bid up interest rates, and crowd out other borrowers. The reality that we see is a credit market that will accommodate both government and private borrowers.

Let's be clear from the outset; the Administration is deeply troubled by deficits. Like taxes, deficits are used to finance excessive government spending which absorbs resources better left in the private sector. We are opposed to them as a matter of principle; and intend to see a budget in balance ultimately.

But the deficit must be put in some perspective; it can't be viewed in isolation from the rest of the economy. Granted, viewed in isolation and in terms of sheer dollars, the projected budget deficit is the largest in our history.

But that does not hold true if you put the deficit in the context of the total economy. For fiscal 1983, we're projecting a deficit that amounts to 3.1 percent of the gross national product. The fiscal 1976 deficit amounted to 4.5 percent of the gross national product.

Nevertheless, won't financing a deficit of that magnitude

drive up interest rates and "crowd out" other borrowers? We don't believe it will.

Private saving, resulting from normal growth and the effects of the Economic Recovery Tax Act, will be several times the total borrowing requirement of the federal government in fiscal 1983 and fiscal 1984.

Normal year-to-year increases in saving exceed $40 billion each year. This will be supplemented by the additional personal savings and additional business earnings induced by the tax cuts.

Compared to 1981, private saving will be more than $60 billion higher in 1982, more than $170 billion higher in 1983, and more than $260 billion higher in 1984. Private saving was just under $480 billion in 1981; it will rise to more than $740 billion in 1984.

The net additions to total private saving are larger than the increase in the deficit. If anything, we'll see "crowding in," rather than "crowding out."

The fourth myth one hears repeated lately is: We must raise taxes to balance the budget.

Far from it. The cause of the current and projected deficits -- more than any other factor -- is a lack of economic growth.

The only way to balance the budget, while raising living standards, is through economic growth that enlarges the tax base. We want to see growing payrolls that will contribute to federal revenues, not higher taxes on a declining number of workers and businesses.

The government has tried time and time again to balance the budget with tax increases. And it hasn't accomplished the objective.

Between 1974 and 1981, despite several legislated tax reductions, overall federal tax receipts rose $338 billion; yet we still accumulated deficits of $350 billion, and today have a national debt in excess of a trillion dollars.

Raising taxes does not balance budgets; raising taxes makes spending easier. Tax increases simply give the federal government more to spend on federal programs that create constituencies for even greater spending.

Now we're faced with any number of proposals to raise taxes in the name of balanced budgets. Many a member of Congress who once worshipped at the shrine of John Maynard Keynes and deficit financing has undergone a transformation more sudden and miraculous than St. Paul's conversion on the road to Damascus.

One proposal would have increased taxes by some $200 billion -- a course that would have meant massive cuts in defense spending and in Social Security benefits. The economy would have stopped dead in its tracks for years.

Many members of Congress believe the deficits are caused by the massive tax cuts enacted last year. The general perception is that federal revenues have been slashed to an historically low level, and that revenue increases are needed to fund essential Government functions. This is another myth.

In the 1960's, taxes as a percent of GNP averaged 18.6 percent.

In the 1970's, taxes as a percent of GNP averaged 18.9 percent.

In 19 of the last 25 years, taxes as a percent of GNP were lower than the 19.4 percent level projected in fiscal 1983.

Postponing the tax cuts, or eliminating them altogether would transform a tax program oriented toward work, and saving, and productivity into just another attempt to fine tune the economy.

Tampering with the July '82 tax cut should be anathema to even the most doctrinaire Keynsian. That tax cut will occur at just the right time to feed the momentum of recovery. Eliminate it and recovery would probably be out of the question during 1982.

And, if the 1983 tax cut is postponed, or eliminated, or made contingent on future economic performance, we'd be injecting the most toxic of elements into the economic system -- uncertainty.

I might add that the small businessman would be especially affected by any change in the Administration's program of general tax rate reduction because typical small businessman is unincorporated and pays a personal income tax.

When the President took office, he promised the country that it would no longer be subjected to business-as-usual. That is precisely what we'd have if the program of tax rate reduction is undermined.

If, as Francis Bacon said, "History makes men wise," then we'd do well to learn from past attempts to attack deficits through tax increases rather than spending cuts. President Lyndon Johnson imposed a surtax of 7.5 percent in 1968, ten percent in 1969, and 2.5 percent in 1970.

And from late 1969 to late 1970, real gross national product declined one percent and unemployment almost doubled. But more to the point, the deficit -- from being marginally in balance in 1969 -- grew to $23 billion in 1971. The tax increases reduced

saving, investment and gross national product, and led to a higher deficit.

If anything, that marginal balance of $3.2 billion in the 1969 budget was an exception that proved the rule: Taxes won't balance the budget, they'll simply bloat the government.

Tampering with the tax program in the name of balancing the budget would send a clear, unmistakable message to the economy -- a message that would say, "We're back to business-as-usual -- back to the old stop and go policies."

That message will confirm the market's belief that the government -- specifically the legislative branch -- is incapable of taking the long-term actions necessary for real growth. And that belief in turn will keep interest rates high.

These are just a few of the myths that have gained currency in recent weeks. There are others: For example, some still believe we're cutting government spending in an absolute sense. We're not; we're simply slowing the rate at which government spending has grown.

The last time that federal spending accounted for less than twenty percent of the gross national product was in 1974. Last year it accounted for twenty-three percent -- almost one in every four dollars generated by the economy.

Our purpose is not to cut government spending <u>per se</u>, but to reduce its share of the gross national product. In this way we can make greater resources available to the private sector -- resources that can be used productively.

Another myth is that we're cutting taxes. In fact, we're not cutting taxes in an absolute sense; we're preventing them from rising as high as they would have because of increases in social security taxes during the last Administration, and because of bracket creep.

Neither our tax program nor our efforts to cut the growth of federal spending are mere doctrinaire adherence to ideology. They are very much the product of pragmatism. Our objective in both instances is to prevent the government from encroaching further on the resources that the private sector needs in order to grow in productivity.

Having said that, I would also point out that our economic policies do rest on a foundation of principle. It has been proven again and again, and can be summed up quite handily in two words -- private enterprise.

We believe in the market place, we believe that the entrepreneur, given enough incentive and enough regulatory room to maneuver, will work miracles, using what President Reagan

called "the magic of the marketplace."

Far too often we in government think, and act, and speak in terms of what we -- the government -- will do. In fact, there is little of a lasting and productive nature that government can do, other than to establish a hospitable atmosphere for the intelligence, the creativity, and the talent of individuals -- men and women who are willing take the risks that have made this nation the great economic power that it is.

That is precisely what this Administration is trying to do -- establish an economic atmosphere that is conducive to work and to saving, to risk and to enterprise.

We believe in the words of the Seventeenth Century English poet James Graham that, "He either fears his fate too much or his desserts are small, who will not put it to the touch to win or lose it all."

We believe that the adventurous spirit of the entrepreneur is alive still and that, if given the right circumstances, it will again pervade the economy.

We believe that the free marketplace is the most effective means of allocating goods and services.

We believe in applying these free market principles most of all because economic freedom and political freedom are indivisible.

Shakepeare wrote that brevity is the soul of wit. And, if that's true, then one of our Presidents, Calvin Coolidge to be precise, was one of the wittiest men to live in this century.

The story is told of a White House press conference during which reporters were vainly firing their questions at Calvin Coolidge.

"Have you anything to say about Prohibition?"

"Nope."

"Have you anything to say about the World Court?"

"Nope."

"About the farm situation?"

"Nope."

"About the forthcoming senatorial campaign?"

"Nope."

The meeting broke up and the reporters began to file out of the room.

At that point Coolidge called out to the departing reporters, "And don't quote me."

It's obvious that I can't approach Mr. Coolidge in brevity, and sometimes I'm not so sure about wit. But one thing I'm positive of is this: You certainly may quote me as I touch on

the final myth.

That myth has not gained widespread attention, but some of you may have heard speculation about the possibility of another depression. Nothing could be more absurd nor further from reality. This nation is nowhere near that fate.

Quite the contrary, our program -- combined with a Congressional resolve to continue reducing the growth in spending -- will bring this nation out of the twilight of recession and into the broad daylight of prosperity. We are about to see the dawn of a new era -- an era marked by stable prices and low interest rates -- an era marked by productivity and initiative -- an era marked by confidence and growth.

As I said earlier, government can only create the environment for capital investment, only you can put that capital to work. Government can create an environment hospitable to talent and innovation, but only you can bring them to bear in the economy.

Government can create an economic climate in which risk is rewarded; what it can't create is the willingness to take that risk.

Only you, and others like you throughout the country, can summon the entrepreneurial spirit that welcomes risk. I'm asking you, as I have asked others around the country, to seize the opportunity that the Administration's program offers.

Winston Churchill once pleaded with Franklin Roosevelt, saying: "Give us the tools and we will finish the job."

We've given you the tools, and trust that you will, begin and finish the job of restoring the nation's economy.

Thank you.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. March 9, 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 $9,600 million, to be issued March 18, 1982. This offering will provide $ 325 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $9,280 million, including $1,222 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $2,197 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 $ 4,800 million, representing an additional amount of bills dated June 18, 1981, and to mature June 17, 1982 (CUSIP No. 912793 7J 9), currently outstanding in the amount of $ 11,630 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 4,800 million, to be dated March 18, 1982, and to mature September 16, 1982 (CUSIP No. 912794 BL 7).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing March 18, 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, March 15, 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 three decimals, e.g., 97.920. 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 March 18, 1982, in cash or other immediately-available funds or in Treasury bills maturing March 18, 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

REMARKS BY
THE HONORABLE R. T. McNAMAR
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE
CALIFORNIA SAVINGS AND LOAN LEAGUE
1982 MANAGEMENT CONFERENCE
SAN DIEGO, CALIFORNIA
MARCH 4, 1982

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

Today I'd like to begin my remarks by trying to paint a picture of an economic environment. Of course, since this is a podium and not an easel, I'll have to paint my picture with some words.

In this economic environment, year after year went by with a low and stable inflation rate, coupled with low and stable interest rates.

The country's industrial structure had emerged unscathed from a terrible war, and was the envy of the entire world. Real increases in national income and productivity meant consistently rising real incomes for the majority of the populace.

Cheap gasoline opened up more cheap land in the suburbs, helping to control housing costs. And economic growth and rising real incomes, combined with the growing families of the baby boom era, generated both the demand for more and larger houses, and the ability of more people to pay for them.

Out of previous, less stable environments a financial structure had developed that encompassed a variety of specialized institutions. Specialization was defined by law, and included restrictions on geographic, product and price competition.

Investment banking was separated from commercial banking, and interstate banking was forbidden. Thrifts were restricted in their activities to mortgage lending on the asset side, and to the short end of the yield curve on the liability side. The fixed rate, level payment, long-term mortgage replaced the short-term, balloon payment mortgage that had proven to be such a disaster in the deflation of an earlier era.

Special tax breaks for thrifts as well as the deductibility of interest expense to mortgage holders reflected a national priority to house the baby boom generation, and to use thrift passbook savings as the means to finance that housing.

Computers were developed during this period, and as they became larger and more efficient, they became more and more affordable to financial institutions. Indeed, no institution could afford to be without one, because they were the means by which productivity improvements came to financial services and kept unit costs declining.

In this economic environment, thrift institutions prospered as in no other. In many years their market share of savings flows increased, and never did it seriously decline; short-term sources of funds had every appearance of being long-term; liquidity was not a problem. And with a yield curve that was sloped positively year in and year out, borrowing short from passbook savers and lending long to mortgage holders was a sure blueprint for success, particularly when unit operating costs were declining through automation, and when competition was limited by law and by regulation.

In this economic environment, each year and every year thrifts made substantial profits. Management was handsomely compensated and the shareholders annually rewarded with dividend increases.

Of course, you all recognize the economic environment that I have portrayed. It is the United States, circa 1957. Indeed, it is a description of the America that existed from about 1948 until 1973 -- a full quarter century of unparalleled prosperity and security. What a wonderful time.

There is only one problem. Someone defaced my painting. That environment no longer exists. And it will never exist again.

THE CHANGING ENVIRONMENT

The world today, and this is no revelation, is radically different. In just the last nine years, the price of oil has risen one thousand five hundred percent. And with every increase in the price of OPEC oil, the luster of that house in the suburbs has dimmed a little more.

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

The rate of productivity growth decreased from an annual average of 3.1 percent during the first twenty years after World War II to 0.7 percent in the 1973-80 period. America's industrial plant, in short, is no longer the world's envy, but instead is locked in a worldwide competitive struggle for survival.

In the latter part of the last decade, the inflation rate (as measured by the CPI) almost tripled in four years to over 12 percent in 1980. Federal spending rose from $270 billion in 1974 to $660 billion in FY81, and now claims 23 percent of GNP -- almost one dollar in every four generated by our massive economy.

In fact, if one adds to our Federal on-budget deficit the off-budget deficit, Federal loan guarantees, and the credit demands of state and local governments, almost one-half of all credit flows in our economy are now preempted by government.

Demographics have also changed. All those babies of the baby boom generation don't require a third and fourth bedroom any longer. They need a job. Unemployment, which used to be considered shockingly high when it reached five percent, now seems to stick in the area of seven to nine percent.

Today a larger proportion are opting for an apartment or townhouse close to their place of work, rather than a house in the suburbs. At today's inflated prices, and with no money to put down, and facing expensive commuting, heating and cooling costs, they couldn't afford that house even if they wanted it.

Further, the parents of the baby boom generation are now aging. The medical care costs of our society as a whole therefore are rising at an unprecedented rate, as are the costs of income transfer payments from the current working generation to the retired generation, that is, social security.

The external environment has also changed. The U.S. no longer possesses the preeminent military superiority that made the world of the 1950s and 1960s so relatively secure. Reclaiming some measure of the military security that was frittered away in the 1970s is thus another, and expensive, national priority.

Finally, the technological environment has changed. Mainframe computers, of course, have continued to advance, and this continued reduction in processing costs has been of growing importance to financial institutions as wage inflation threatened to get totally out of hand in the last decade.

However, of even greater technological importance has been the extraordinarily rapid development of mini- and micro-computers and of telecommunications. Together these two developments have brought a true revolution to the financial services industry. It is these that have made possible both automated tellers that improve the profitability of traditional depository institutions -- and also money market mutual funds and cash management accounts that in combination with inflation and Regulation Q erode their market share. Who could have handled a sweep account in 1960? 1970?

Inflation provided the impetus for innovation and automation. Mini-computers and telecommunications provided the means. Indeed, the pace of change is accelerating.

The result has been the de facto repeal of a whole host of statutes and regulations that attempted to protect each type of institution from competition by all the others. Glass-Steagall severed depository banking from investment banking. Mini-computers, telecommunications, and money market mutual funds -- packaged together in cash management accounts -- have rebridged the gap. McFadden separated banking in California from banking in New York. Mini-computers, telecommunications, and the American Express card have re-established the link. Interstate banking does take place -- just branching and deposit taking are prohibited today.

Yes, the world has changed. National defense, reindustrialization and medical and old age benefits now compete directly with housing and low mortgage rates as national priorities. And we must find a way to satisfy each and balance them all.

Regardless of what the law tries to establish, virtually all financial institutions now compete directly with virtually all others. And those most bound by the old laws that once seemed so protective are those most mortally threatened by the new economic, technological, and national priority environments.

THE COMPETITION

Most of you are only too painfully aware of the players in today's financial services environment, and of the wide 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, commercial loans in most states, and mortgages in multiple locations.

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

Your competitor, Merrill Lynch, offers stock and bond underwriting, mortgages, check-writing, trust and estate planning, real estate brokerage, personal property management and relocation services, and money management.

Those are only a few examples of your regulated competitors. Your "unregulated" competitors have even 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 brokerage 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". And how many of you don't have at least a Sears catalog store in your town?

Your competitor, American Express, offers credit cards, cable television, securities brokerage, travelers' checks, travel planning, and cash withdrawal at airports nationwide.

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

Even the telephone company could get into the act. How long do you think it will be before a deregulated AT&T sells home computers in its Phone Center Stores? And how long before the combination of debit cards, telecommunications, and that home computer are put together to offer true banking in the home?

A journalist recently compared the state of financial services today with the grocery business of the 1920s. 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 operation.

A recent private study found perhaps an interesting parallel. The average consumer now uses over thirty financial services per year, and goes to more than a dozen financial institutions to obtain them. We are witnessing today a reasonably orderly, but extraordinarily fast-paced, change in this structure, 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, and may even increase. A market for specialized institutions will continue to 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 cabbages from spilling over into the tomato bin, and to keep California tomatoes from being sold in Florida and vice versa. In a changed and changing environment, that just is not possible. The regulatory walls that serve to keep competitors out under one set of circumstances serve only to keep the so-called protected hemmed in in another.

REAGANOMICS

So what are we in the Reagan Administration going to do about all of this? We're going to do two things.

First, as Ed Meese described at length to you last summer, we're going to do everything we can to restore more stable economic conditions in this country -- conditions of low inflation, low and stable interest rates, economic growth, and reward for work, saving and investment. Fortunately, we're beginning to make progress in this area -- particularly in reducing inflation and interest rates.

Achieving more stable economic conditions has been the overriding objective of the four-part Program for Economic Recovery that Ed reviewed with you -- the slow and steady growth of the money supply to reduce inflation, the budget cuts to reduce the bloated size of the Federal Government, the incentive-oriented tax cuts to promote work, saving, and investment, and the regulatory reform program to eliminate costly and counterproductive regulations.

And regulatory reform brings me to the second part of what we in the Reagan Administration are going to do about all of this. We can't promise that, even after more healthy economic conditions are restored, someone else won't be elected someday who will mess it all up again. And we won't and probably couldn't promise to halt or even slow down technological change. What we can do is free all financial institutions to compete and adapt to all manner of changes in our economy, technology, or national priorities.

That is precisely the purpose of the legislation embodied in the so-called Garn Bill, S. 1720, and the Administration's proposal regarding financial services affiliates. We want to give thrifts the expanded asset powers that will allow them to compete with commercial banks. We want to give banks the expanded securities powers that will allow them to better compete with investment banks. And we want to give to both the liberalized liability powers that will allow them to compete with money market mutual funds.

Further, we support other efforts to remove legal and regulatory barriers that inhibit the process of adjustment to economic change. Thus we support the thrusts of the Garn Bill that overturn usury laws and strengthen the enforceability of due-on-sale clauses, for example.

But we do not support suggestions that have as their main thrust protecting existing institutions from competition.

In short, we believe that the safety and soundness of our financial system will best be served not by protecting each and every institution as it existed in 1981, but by freeing all institutions to compete and adjust in 1982 and beyond.

I know that some of you feel that, while the level playing field is a great idea, getting from here to there isn't going to be a very fair game, because the players are starting from very unequal positions. In particular, you feel that the thrifts are in such a weakened condition relative to the commercial banks that they cannot possibly hold their own.

While that certainly may be true in a number of individual cases, I'm not so sure it will bear up under scrutiny across the board. For example, a recent study by a major consulting firm found that the impact of deregulation on commercial banks is likely to be of major proportions. For that industry as a whole, the value of the Regulation Q interest subsidy was estimated at over $40 billion in 1980. By contrast, industry earnings in that year were $20 billion. Thus, all other things being equal, complete immediate deregulation of interest rates in that year would have resulted in an industry-wide swing from $20 billion per year in profits to $20 billion in losses. Clearly, the banks, too, will have to make a lot of adjustments, some of them probably quite dramatic.

Thus the spectre of multinational banks running rampant through the countryside gobbling up every thrift and bank in their paths, and ultimately ending up as the sole survivors of the deregulatory process just doesn't seem very plausible to me. Why buy money that way?

To the contrary, it seems to me that all our financial institutions face the same threat, and that threat is not deregulation. The threat comes from inflation and an economy that has spiraled downhill over the last decade. Such ostensible solutions as All-Savers tax give-aways and mortgage bail-outs are not long-term solutions at all. To the extent that they increase the Federal deficit and increase the Federal role in credit allocation they are, in fact, a major part of the problem.

The only real solution is to continue our battle to restore integrity to our fiscal and monetary processes, and to free the financial industry to compete and adjust.

CONCLUSION

Success in implementing these policies will result in an economic upturn beginning in the spring, and renewed vigor for all our financial institutions. Already there are signs that may be foretelling that development. By the last half of the year, a very strong period of economic growth should be under way.

Long-term success, however, depends very much on how resolute we and the Congress are, and on the response of management in the private sector to that program. As I suggested earlier, we -- the Reagan Administration -- fully intend to stay the course.

We intend to succeed and I believe that you, certainly as much as any others, have a major stake in that success.

Thank you.

TESTIMONY OF:

MARC E. LELAND
ASSISTANT SECRETARY
INTERNATIONAL AFFAIRS
DEPARTMENT OF THE TREASURY

BEFORE THE:
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY
COMMITTEE ON FOREIGN RELATIONS

WEDNESDAY, MARCH 10, 1982

I WELCOME THIS OPPORTUNITY TO APPEAR BEFORE THIS SUBCOMMITTEE TO DISCUSS THE CURRENT STATUS OF U.S.-CANADIAN ECONOMIC RELATIONS. MY COMMENTS WILL FOCUS ON WHAT WE HAVE DONE TO DATE TO ATTEMPT TO RESOLVE THOSE ECONOMIC ISSUES IN CONTENTION BETWEEN THE UNITED STATES AND CANADA, AND HOW WE MIGHT PROCEED IN THE FUTURE.

TO PUT THIS DISCUSSION IN THE LARGER CONTEXT, IT MAY BE USEFUL TO REVIEW THE DIMENSIONS OF OUR ECONOMIC RELATIONS WITH CANADA.

ECONOMIC RELATIONSHIP

THE DEPTH OF UNITED STATES CONCERNS WITH THE CURRENT TREND IN CANADA'S ECONOMIC POLICIES STEMS FROM THE GREAT IMPORTANCE OF OUR ECONOMIES TO ONE ANOTHER, AND THE MAGNITUDE OF THE BILATERAL TRADE AND INVESTMENT FLOWS WHICH THESE POLICIES MAY JEOPARDIZE.

-- We are each other's largest trading partner. In 1980, U.S. trade with Canada exceeded $77 billion, accounting for nearly one-fifth of total U.S. foreign trade.

-- In relative terms, Canada is even more dependent on trade with the U.S. Trade with the U.S. represents 70% of Canada's foreign trade.

-- At the end of 1980, U.S. investment in Canada totalled $45 billion, which represents 20% of total U.S. investments abroad.

-- Canada's private direct investment in the United States now totals $10 billion, or 55% of Canada's total foreign direct investment.

Thus, it is clear that the ties between our economies are so strong that governmental efforts on either side to restrict or control trade and investment have major implications for both economies.

It is for this reason that the current significant differences in our economic approaches is of such concern. This Administration is committed to maintaining open capital markets for the free flow of trade and investment. This is a cornerstone of our Economic Recovery Plan. Our international efforts are directed at eliminating, not creating, barriers to trade and investment, and at reducing government involvement.

The Trudeau government advocates a more interventionist approach to economic issues in general, and trade and investment issues specifically. Nationalism, which translates into increased Canadian control of the economy, is the central theme of the current government.

While we do not object to Canada's desire to increase Canadian ownership in segments of its economy -- that is Canada's decision to make -- we do object to a number of measures the Canadian Government is using to achieve its objectives. While these measures are objectionable in principle, they are even more disconcerting in that they are indicative of a general trend by governments to intervene in trade and investment flows. The proliferation of these measures undercuts our efforts to achieve a liberalization of the world economy.

Specific Issues of Concern

There are a number of specific areas of concern to the United States regarding Canadian investment policy, which we have been attempting to address with the Canadians.

Foreign Investment Review Agency. The Canadian Foreign Investment Review Agency (FIRA) was established in 1973 to screen virtually all types of foreign direct investment in Canada. FIRA screening requirements thus apply before non-Canadians acquire control of Canadian business enterprises, or establsh new businesses, or undertake new activities unrelated to existing businesses. FIRA requirements even extend to mergers between parent companies outside of Canada that involve the transfer of ownership of a Canadian subsidiary. FIRA bases its decision on one principle criterion: Is the foreign investment of "significant benefit" to Canada? We have serious reservations about the manner in which FIRA is being administered:

-- FIRA exacts legally enforceable commitments from firms investing in Canada which may distort trade and investment flows.

THESE MAY INCLUDE COMMITMENTS, AMONG OTHER THINGS, TO PURCHASE A CERTAIN AMOUNT OF CANADIAN GOODS FOR PRODUCTION AND TO EXPORT A CERTAIN SHARE OF CANADIAN PRODUCTION.

-- BY VIRTUE OF ITS REVIEW PROCESS FIRA CAN RESTRICT FOREIGN ENTRY, BY BLOCKING NEW INVESTMENTS BY NEW OR EXISTING FOREIGN INVESTORS, AND BY PROHIBITING THE SALE OF CANADIAN ASSETS TO NON-CANADIAN FIRMS. A FIRA ACTION TO BLOCK THE TRANSFER OF OWNERSHIP OF A CANADIAN SUBSIDIARY FROM ONE FOREIGN FIRM TO ANOTHER COULD LEAD TO THE SALE OF FOREIGN ASSETS AT DEPRESSED PRICES.

NATIONAL ENERGY PROGRAM. ALSO OF SERIOUS CONCERN TO THE UNITED STATES IS THE CANADIAN NATIONAL ENERGY PROGRAM (NEP), WHICH IS DESIGNED TO PROMOTE INCREASED CANADIAN OWNERSHIP OF CANADA'S ENERGY SECTOR. LEGISLATION IMPLEMENTING THIS PROGRAM CONTAINS PROVISIONS THAT ARE DISCRIMINATORY, AND/OR EXPROPRIATORY, AND WHICH DEPART SIGNIFICANTLY FROM ACCEPTED INTERNATIONAL ECONOMIC PRINCIPLES, SUCH AS NATIONAL TREATMENT. THESE PROVISIONS WILL ADVERSELY AFFECT UNITED STATES FIRMS. WE HAVE SPECIFIC PROBLEMS WITH THE TWO PIECES OF IMPLEMENTING LEGISLATION.

BILL C-48

OUR PROBLEMS WITH BILL C-48, WHICH WAS RECENTLY ENACTED, INCLUDE:

-- INADEQUATE COMPENSATION FOR THE 25 PERCENT INTEREST IN OIL EXPLORATION PERMITS AND LICENSES (AND SOME) LEASES ARROGATED RETROACTIVELY TO THE GOVERNMENT;
-- THE REQUIREMENT THAT FIRMS OR CONSORTIA BE 50 PERCENT CANADIAN-OWNED AND CONTROLLED TO OBTAIN A PRODUCTION LICENSE ON FEDERAL LANDS; AND
-- PROVISIONS DESIGNED TO ENSURE THAT CANADIAN SUPPLIERS

are considered on a "competitive basis". These provisions will be implemented by the Committee on Megaproject Industrial and Regional Benefits, which will determine why Canadian goods weren't purchased for a project and how the firm involved plans to ensure that Canadian suppliers are considered in the future.

Energy Security Act (ESA)

The other piece of implementing legislation, the Energy Security Act (ESA), was introduced to the Canadian Parliament on February 28, and is expected to be enacted into law within a month. The ESA contains several discriminatory measures, including the Petroleum Incentives Program (PIP). Under the PIP, energy firms operating in Canada are eligible to receive Federal incentives in excess of the 25% given to all companies only if they meet certain Canadian ownership and Canadian control criteria. The PIP will replace depletion allowances available to all firms.

The ESA also contains a number of other onerous provisions amending the Canada Business Corporations Act. These provisions permit Canadian corporations to force minority foreign shareholders to sell their holdings in these corporations against their will. Implementation of these provisions may lead to substantial losses for U.S. and other minority foreign shareholders in Canadian companies in the energy sector. It also appears that the application of these provisions may have spillover effects on companies in other sectors, particularly foreign securities firms. Measures such as these distort international capital flows and certainly will not promote investor confidence in Canada.

Response of the U.S. Government

The U.S. Government is extremely concerned with Canadian policies. We do not want to respond to these policies in a way, however, which would be detrimental to U.S. national interests, and/or would jeopardize the international economic system. In our view, any actions to restrict foreign investment in the United States would adversely affect U.S. national interests and the domestic Economic Recovery Program, and probably would not be effective in inducing changes in Canadian policies.

The United States has pursued its concerns with Canadian policies in a number of different fora:

-- Bilaterally, a number of high-level consultations have occurred.

-- Multilaterally, we have raised our concerns in the OECD and the GATT.

I will briefly review these initiatives.

Bilateral Initiatives

On a bilateral basis, the Administration has held extensive consultations with the Government of Canada regarding its policies. These consultations have produced some changes but they are clearly not sufficient, and we are pressing for further modifications in the NEP and the FIRA. We are considering actions, therefore, under domestic law, including a possible action under Section 301 of the Trade Act.

Multilateral Initiatives: GATT and OECD

The U.S. Government, as well as other countries, have expressed their concerns regarding Canada's trade and investment policies in

BOTH THE GATT AND THE OECD. IN THE GATT, WE INITIATED AND HELD ARTICLE XXII CONSULTATIONS WITH RESPECT TO TRADE-RELATED PERFORMANCE REQUIREMENTS ASSOCIATED WITH THE FIRA. WE ARE PREPARING A CASE UNDER ARTICLE XXIII, UNDER WHICH A GATT PANEL WOULD CONSIDER WHETHER SPECIFIC CANADIAN TRADE PRACTICES VIOLATE ITS OBLIGATIONS UNDER THE GATT. IN ADDITION, IF CERTAIN ASPECTS OF THE NEP ARE CARRIED OUT IN A DISCRIMINATORY MANNER, WE WILL CONSIDER INITIATING ARTICLE XXII CONSULTATIONS ON THE NEP.

WE HAVE ALSO RAISED THESE ISSUES ON SEVERAL OCCASIONS IN THE OECD. AS MENTIONED EARLIER, WE BELIEVE THAT THESE MEASURES INSTITUTED BY THE CANADIAN GOVERNMENT ARE INDICATIVE OF A GENERAL TREND BY GOVERNMENTS TO INTERVENE IN TRADE AND INVESTMENT FLOWS BY APPLYING DISCRIMINATORY REQUIREMENTS. IN OUR OPINION, THERE NEEDS TO BE MORE INTERNATIONAL CONSIDERATION OF THE EFFECT OF THESE TYPES OF PRACTICES, AND ULTIMATELY SOME DISCIPLINE IMPOSED ON THEIR USE. THEREFORE, WE PRESSED FOR FURTHER EXAMINATION OF THESE ISSUES IN THE OECD, AND WERE PLEASED WITH THE RECENT AGREEMENT BY THE OECD TRADE COMMITTEE TO INITIATE A STUDY ON TRADE-RELATED PERFORMANCE REQUIREMENTS. ADDITIONAL WORK ON THIS SUBJECT AND THE ISSUE OF INVESTMENT INCENTIVES WILL ALSO BE DONE BY THE OECD INVESTMENT COMMITTEE.

IN ADDITION, THE U.S. GOVERNMENT PROPOSED AT THE MARCH AND SEPTEMBER 1981 GATT MEETINGS THAT THE GATT UNDERTAKE A SYSTEMATIC STUDY OF TRADE-RELATED INVESTMENT PERFORMANCE REQUIREMENTS AND INCENTIVES, STARTING WITH THE DEVELOPMENT OF AN EXHAUSTIVE LISTING OF THESE MEASURES COMPARABLE TO THE NTB INVENTORY DEVELOPED FOR THE TOKYO ROUND NEGOTIATIONS.

OECD Ministerial/ Economic Summit/ GATT Ministerial

There are a number of high level multilateral meetings in the coming months at which the U.S. plans to take the lead in opening a discussion of investment policy and discriminatory practices. These include the OECD Ministerial in May, the Economic Summit in June, and the GATT Ministerial in November. In our view, the proliferation of egregious investment policies and practices make it essential to escalate this issue. Canada's policies are exemplary; but it is not the only country which employs such practices.

International institutions and multilateral rules have been developed in virtually every other area of international economic relations. We believe that it is time to begin to develop on a multilateral basis effective "rules of the road" in order to control these practices. Our ultimate objective at these meetings will be to reach agreement on this objective and to initiate related work towards this objective.

We intend to use the OECD Ministerial and Economic Summit to begin to generate developed country support for our initiative. At the GATT Ministerial, we hope to have the Ministers agree on the adoption of a work program which includes a major review of discriminatory and distorting investment policies. Included in this revew would be an analysis of how the GATT might be strengthened to deal with trade related investment policies. This work program would provide the basis for proceeding with the development and negotiation of multilateral "rules of the road" for investment.

CONCLUSION

CANADIAN INVESTMENT POLICIES CLEARLY CAUSE US CONCERN, BUT ARE AT THE SAME TIME PUZZLING. THE POLICIES BEING ENACTED BY THE GOVERNMENT OF CANADA RAISE QUESTIONS ABOUT ITS DESIRE TO ATTRACT FOREIGN INVESTMENT. CERTAIN ELEMENTS OF THE CANADIAN ECONOMY HAVE ALSO QUESTIONED THE GOVERNMENT'S METHODS. AT THE SAME PUBLIC STATEMENTS BY CANADIAN OFFICIALS INDICATE THAT CANADA WELCOMES FOREIGN INVESTMENT.

WHILE THESE POLICIES HARM U.S. INTERESTS THEY ARE, AS WE HAVE POINTED OUT, ALSO POTENTIALLY VERY HARMFUL TO THE CANADIAN ECONOMY. THE GOVERNMENT OF CANADA, HOWEVER, HAS DECIDED THAT THESE POLICIES ARE IN THEIR BEST INTERESTS.

THIS ADMINISTRATION IS SERIOUSLY DISTURBED BY CANADA'S DISCRIMINATORY INVESTMENT POLICIES. WE HAVE RAISED OUR CONCERNS AT THE HIGHEST LEVELS IN BILATERAL MEETINGS. WE HAVE TAKEN CANADA TO THE GATT. IN ADDITION, WE HAVE INITIATED FURTHER WORK ON PERFORMANCE REQUIREMENTS AND OTHER DISCRIMINATORY TRADE AND INVESTMENT PRACTICES IN THE OECD AND WILL PROPOSE THAT SIMILAR WORK BE UNDERTAKEN IN THE GATT. WE WILL CONTINUE TO WORK WITH CANADA BILATERALLY; AND WE WILL CONTINUE TO PURSUE THESE PROBLEMS VIGOROUSLY IN MULTILATERAL FORA, AS WELL, IN AN EFFORT TO RESOLVE OUR DIFFERENCES.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. March 10, 1982

TREASURY TO AUCTION 2-YEAR AND 4-YEAR NOTES TOTALING $9,000 MILLION

The Department of the Treasury will auction $5,250 million of 2-year notes and $3,750 million of 4-year notes to refund $6,037 million of notes maturing March 31, 1982, and to raise $2,963 million new cash. The $6,037 million of maturing notes are those held by the public, including $335 million of maturing 2-year notes and $356 million of maturing 4-year 1-month notes currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $888 million of the maturing notes that may be refunded by issuing additional amounts of the new notes at the average prices of accepted competitive tenders. Additional amounts of the new securities may also be issued at the average prices to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that their aggregate tenders for each of the new notes exceed their aggregate holdings of each of the maturing notes.

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

Attachment

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R-669

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC OF 2-YEAR AND 4-YEAR NOTES TO BE ISSUED MARCH 31, 1982

March 10, 1982

ount Offered:		
To the public	$5,250 million	$3,750 million
scription of Security:		
Term and type of security	2-year notes	4-year notes
Series and CUSIP designation	Series Q-1984 (CUSIP No. 912827 MZ 2)	Series G-1986 (CUSIP No. 912827 NA 6)
Maturity date	March 31, 1984	March 31, 1986
Call date	No provision	No provision
Interest coupon rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction
Interest payment dates	September 30 and March 31	September 30 and March 31
Minimum denomination available	$5,000	$1,000
Terms of Sale:		
Method of sale	Yield Auction	Yield Auction
Accrued interest payable by investor	None	None
Preferred allotment	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment to be submitted with tender
Deposit guarantee by designated institutions	Acceptable	Acceptable
Key Dates:		
Deadline for receipt of tenders	Wednesday, March 17, 1982, by 1:30 p.m., EST	Wednesday, March 24, 1982, by 1:30 p.m., EST
Settlement date (final payment due from institutions)		
a) cash or Federal funds	Wednesday, March 31, 1982	Wednesday, March 31, 1982
b) readily collectible check	Monday, March 29, 1982	Monday, March 29, 1982
Delivery date for coupon securities	Wednesday, April 7, 1982	Wednesday, April 14, 1982

TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
Expected at 7:30 P.M.,
Thursday, March 11, 1982

ADDRESS
BY
SECRETARY OF THE TREASURY
DONALD T. REGAN
BEFORE THE
FINANCIAL WORLD DINNER
NEW YORK CITY, NEW YORK
MARCH 11, 1982

It is good to be back in New York among so many friends. Having left the financial world and gone to the nation's Capitol, I can tell you that my new job is really much easier than yours.

All we have to do in Washington is get interest rates down, end the recession, pay off a trillion dollar debt, and find out who takes notes at Al Haig's staff meetings.

I do have one advantage that Al doesn't. I know where my critics are: on Wall Street, on the record, and on television. It's getting so the two most valued qualifications for a good analyst are an MBA from Harvard and makeup from Elizabeth Arden.

Nevertheless, there is a very legitimate debate going on in this country about the economy. Most would say it was sparked by the recession and ignited by the Administration's fiscal 1983 budget. Perhaps so, in the short term. But in the long term it was sparked by the people of this country who said in the last election they had had enough short term economic thinking.

They asked for a recovery program that would reduce inflation, reduce interest rates and get us moving toward sustained economic growth. The President responded to that challenge. And I believe we are on a soundly constructed course to realize those objectives.

Tonight I want to discuss one of the elements of the President's program that is crucial to achieving real non-inflationary growth. It also goes to the heart of our short-term debate. That issue is money and monetary policy.

I realize that talking to this audience about the basics of money is a little like talking to the New York Yankees about how to hit a baseball. But I also know that within the last two weeks we have seen some heavy hitters from a variety of chief

R-670

executive suites express some rather harsh views about deficits and interest rates. So let's go back to basics for a moment.

First, 'the basics' is where the truth is. And secondly, there is a lingering, serious misunderstanding among many people about the role of money and monetary policy.

Let me give you one example. Paul Volcker testified last month before the House Banking Committee. It was an open hearing, with written copies of the testimony available to anyone who wanted them. The following morning the Washington Post account of the hearings was headlined (front page) "Fed Plans to Ease Monetary Policy." Simultaneously, the New York Times headline, based on the same hearing was, "Volcker Says Fed Plans to Continue Tight Money Stand." Is it any wonder people are confused about what is going on along the Potomac?

The monetary policy of this Administration rests on two basic ideas. First, inflation is fundamentally a monetary phenomenon -- a situation which cannot persist without excessive money growth. Second, the rate of monetary expansion is the result of the actions of the Federal Reserve. Within this framework, the task of monetary policy is simple and straightforward: achieve and maintain a steady moderate rate of money growth.

I want to emphasize this point -- the correct monetary policy is absolutely necessary for reducing inflation and less inflation is absolutely necessary for achieving the full potential of the economic recovery program.

The most important requirement is that the Federal Reserve not back away from its efforts to reduce the trend of money growth. Monetary finetuning -- aimed either at driving interest rates down or boosting output and employment -- must be avoided.

I hear a growing chorus of recommendations from some segments of the economic profession that we need an "easier" monetary policy to stave off the recession. Those critics would have us return to the very type of policy which helped greatly to create the problem of stagflation. We must not again lose sight of the fact that money is not a substitute for economic incentives. Money is not the football game, it is only the ticket into the stadium.

What is truly important in an economy are the real assets: the real property, the capital and, most important, the human resources: the creativity, dedication and plain hard work of the men and women who make the economy go. Money exists to provide a consistent measure of the value of their real resources and their outputs. It facilitates trade and ultimately increases the productivity of human resources.

"Money," as Henrik Ibsen once wrote, "may be the husk of

many things, but not the kernel."

Past policy failures reflected efforts to substitute money for real goods. And those failures were based on the logical fallacy that since money represents goods, more money means more goods.

Despite recent financial innovations, the fundamental link between money and economic activity has not changed. And also despite the innovations, money growth still is determined principally by the actions of the Federal Reserve Board.

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, steady growth in the money supply.

In an ideal world, the supply of money should expand at the same rate at which the real economy is expanding. Money growth throughout the entire term of 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.

The Administration agrees with and supports the Federal Reserve Board's announced target ranges for both 1981 and this year. Our support for their stated objective is complete and unequivocal. If there have been disagreements they are emphatically not over policy. The disagreements -- to the extent that there have been any -- have arisen when actual money growth strayed for several months either significantly above or below those ranges.

When the markets see an accelerating money growth pattern, they increase interest rates to cover for future inflation. When the markets see 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. That's where the uncertainty premium comes in.

In spite of the recent upward movement, the basic policy is yielding, and will continue to yield, lower interest rates. Clearly, many observers do not agree. Now why is there such a lack of consensus even on the basic direction that interest rates will head? I think there are two reasons.

First, there is a difference of opinion over the relative power of market forces.

Our critics 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. After all, they reason, we are talking about the largest deficits in history -- they must have a large effect.

According to this argument, 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.

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.

All that sounds very compelling. But it is wrong.

So what is the case for declining interest rates? Our case, it turns out is based on Adam Smith -- the part in his book where he says people would rather make money than lose money.

Interest rates consist of three parts: the real rate, the inflation premium and an uncertainty premium. Deficits, if they are very large, tend to put upward pressure on the real rate which has historically been around 3-4 percent; this effect, however, is slight. Of more consequence is the inflation premium. If a lender thinks the rate of inflation will be lower in the future, he can reduce his overall rates and still expect to make a buck. Today, slow, steady money growth and declining inflation are putting strong downward pressure on the other two components.

There is unquestionably 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: growth in money compared to growth in output was slower over much of 1976 than in 1975.

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 large 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 5 percent, interest rates continued their downward trend. Not until late 1976 did rates move up. Because not until late 1976 was money growth increased sharply.

I do not mean to downplay the significance of the budget deficit. Instead, I want to put it in perspective. We see the projected deficits as a sign of a serious lack of discipline on the part of government. Certainly, growth in government spending represented by the deficit crowds out the private sector. The underlying problem is the enormous amount of resources which flow to or through the government. Restoring the potential of the economy requires that we attack the deficit problem at its source -- the growth of government spending.

Today, the market place has become very astute in analyzing the actions and intentions of the Fed. 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 a few months ago.

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.

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. It is not 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 neither we nor the

Federal Reserve intends -- it affects only the demand for credit. Growth in credit is not inflationary.

Let me put it this way: More money does not mean more credit and less money does not mean less credit.

The tax cut element of the President's program was designed specifically to increase savings -- that is, real credit -- and thereby expand the economy's ability to supply more goods. And this has already started to happen.

We are projecting that the increase in total private savings from last year to this year will be in the neighborhood of $60 billion and that the savings pool will grow by some $250 billion by 1984.

It has been projected that Federal borrowing this year, including off-budget financing, will consume 22 percent of total funds raised in the credit market. This compares, by the way, with 1975 when government borrowing constituted 42 percent: A year when interest rates were declining.

In summary, we must view monetary policy, 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.

Let me conclude with a very simple analogy. Ask yourself this question: Does eating food make children grow? Think about that for just a moment.

We tend to think that the answer is yes. But it does not work that way. As the body develops, it demands food to replace the expended energy and perpetuate the on-going growth. 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.

Economies, like people, have a natural tendency toward creative growth and toward self-correction. Money exists to follow and facilitate that activity; not to make it happen.

The course we have charted requires discipline and courage on the part of all of us. But, believe me, it is the only course which will lead to sustained lowering of interest rates.

Sound public policy can come from the government. But real economic growth can only come from the private sector. And that leads to the responsibility of those of you in business.

Recently we have heard from the Business Roundtable and other CEO's about the need to raise taxes. They even suggested that we might want to raise individual tax rates and keep the cuts for business. That's not exactly the kind of big-picture thinking that will engender much support from the American

people.

Nor does it hold much water with me. Now is the time for business leaders to show strength, not timidity; statesmanship, not parochial interests.

The American economy, the most massive and complex in the world, resembles one of those million-ton oil tankers. You can't turn them around on a dime, or slam on the brakes if they are off course. Our economy is the same way. But the captain on the bridge has signalled the turn, the rudder has been moved, the engine room is operating under a new set of commands, and I believe the economy will respond.

I will be the first to admit that when you're sitting in a corporate management seat today, the view is bleak. Unemployment is up. Sales and profits are down. And when managers start to lose money, they ask what national policies can be changed to help rewrite their profit and loss sheets. That's a legitimate question.

But its a little like the baseball team that has a 162 game schedule. Yet the minute they lose three in a row, the fans shout, "We're in a slump, bench the pitchers and fire the coach."

That's the short term thinking that has prompted some professional critics to start shouting, "depression." That kind of fire-in-the-theatre language is just plain irresponsible.

The business community should not forget the free enterprise principles upon which our program is based. Don't forget that if you want less government in your economic business, it means putting more of your business in the economy of the country.

It also means helping Congress get on with the job of passing the President's budget, cutting Federal spending, and giving the country some assurance that our program will be enacted.

Flailing at windmill deficits will not get them down. Nor will short-sighted attempts to sacrifice the economic and business tax incentives.

And neither will reneging on the personal tax cuts, hoping that the increased revenue will wipe out the deficit. On the face of it this seems like common sense. But it won't be used that way. We've got to recall what Columbus told Isabella: "Common sense tells you that the world is flat."

That kind of common sense doesn't work in the Washington environment where Congress tends to keep its spending up to the level of your taxes. Lest we forget, in 1980 tax revenues increased by $54 billion. Did that mean the money was used to eliminate the deficit. No. Congress found ways, as it will

always find ways, to spend that money. In 1980, instead of a shrinking deficit, we had one of our largest deficits in history.

The right way to end deficits is controlling government spending on the one hand, and increasing revenues -- not tax rates, but tax revenues -- as a result of expanded economic activity. And that is precisely the program that this Administration is pursuing.

Much of the deficit is a transition problem caused by the recession, and it should improve as the economy recovers. Nevertheless, government spending is the root cause. And I would personally support the idea that, over time, we should require a balanced budget forcing the Administration and Congress to reduce Federal spending and limit the growth in tax revenues.

That's the course we're taking today in the President's budget.

It is a budget that accommodates the need for a strong national defense. It meets our compassionate social commitments. And it restores trust in the integrity of government. That, and not quibbling about this or that percentage, this or that budget line item, is what it is all about.

We are on our way toward gaining a treasure beyond value: a currency and an economic policy we can trust, not one that, because of cynicism linked to lack of imagination, seeks once again to corrupt our system by perverting its economic and psychological foundation.

Make no mistake about it, ladies and gentlemen, we are playing for high stakes in this budget and in this economic policy. The stakes are nothing less than the survival of a free economic system.

Now is the time for strength and courage in seeing that we are successful -- and that we move on to the lasting prosperity our economic system can provide.

Thank you.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE
March 11, 1982

CONTACT: George G. Ross
(202) 566-2041

STEVEN R. LAINOFF APPOINTED ASSOCIATE INTERNATIONAL TAX COUNSEL

The Department of the Treasury today announced the appointment of Steven R. Lainoff as Associate International Tax Counsel and Associate Director of the Office of International Tax Affairs. The appointment was effective as of March 1, 1982.

Prior to joining the Treasury in January 1981, Mr. Lainoff was with the New York law firm of Coudert Brothers, and was an Adjunct Assistant Professor of Law at the New York University School of Law, Graduate Tax Program.

As Associate International Tax Counsel, Mr. Lainoff will assist International Tax Counsel Alan Winston Granwell in the formulation of policy, legislation, and regulations on international tax matters, including the taxation of foreign source income of U.S. taxpayers, the taxation of foreigners receiving income from U.S. sources, and the prevention of international tax evasion.

The Office of International Tax Counsel is one of three major units under the Assistant Secretary for Tax Policy. The other units are the Office of Tax Legislative Counsel and the Office of Tax Analysis.

A native of New York City, Mr. Lainoff received his B.A. degree from Boston University in 1974; his J.D. in 1977 from the University of Arizona School of Law; and his LL.M in Taxation in 1978 from the New York University School of Law.

# # #

R-671

TREASURY NEWS

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

FOR RELEASE AT 12:00 NOON March 12, 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 March 25, 1982, and to mature March 24, 1983 (CUSIP No. 912794 CA 0). 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 March 25, 1982. In addition to the maturing 52-week bills, there are $9,255 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 $1,961 million, and Federal Reserve Banks for their own account hold $3,110 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 $ 502 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, March 18, 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.

R-672

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 three decimals, e.g., 97.920. 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 March 25, 1982, in cash or other immediately-available funds or in Treasury bills maturing March 25, 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

STATEMENT OF R. T. McNAMAR
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE COMMITTEE ON AGRICULTURE,
NUTRITION AND FORESTRY
UNITED STATES SENATE
MARCH 12, 1982

MR. CHAIRMAN: I welcome this opportunity to discuss the relationship between the Polish financial and economic situation and the Commodity Credit Corporation's export lending activities with you and other members of the Committee.

As you know, we have already submitted for the record the answers to the questions you posed in preparation for these hearings. I have attached those questions and answers to this statement. Therefore, in my prepared statement, I will elaborate on two of the major points of your concern.

I would like to begin by commenting on the reasons why the Administration has chosen not to declare Poland in default at this time. There has been considerable confusion and misunderstanding in the press and elsewhere regarding this decision.

Subsequent to the imposition of martial law in Poland on December 13, 1981, the United States and other official creditors decided to take the following initial steps to bring financial pressure to bear on the military government of Poland: (1) Government credits and export guarantees, except those of a humanitarian nature, were terminated; (2) 1982 Polish debt rescheduling discussions were indefinitely suspended; and (3) official creditors insisted that Poland meet its 1982 obligations as they fall due and pay up the arrearages on the 1981 obligations that were not previously rescheduled during 1981.

R-673

The U.S. has also taken a number of additional steps:

-- We have suspended Poland's 1982 fishing rights in U.S. waters.

-- We have halted the renewal of the U.S. Export-Import Bank's line of credit insurance to Poland.

-- We have held up the shipment of surplus dairy products.

-- We have suspended Polish civil aviation landing rights in the U.S.

By taking these steps we instituted a process so that money is now flowing from Poland to the West rather than the West to Poland as was the case during the last several years. By adhering to a policy of insisting on repayment while not providing any new funds -- the private lenders have also severely curtailed lending to Poland -- we are creating a situation that maintains financial pressure on the Polish military regime and through them on the USSR.

Some have argued that a formal declaration of default would serve to curtail financial credit to Poland. There are no credits going to Poland at this time, and some of the other Soviet bloc countries, which are experiencing serious economic and financial problems, are finding it increasingly difficult to borrow.

Although a formal declaration of default would not affect Poland's legal obligation to repay its debts to U.S. lenders, the Polish government could attempt to avoid paying U.S. lenders. In turn, this would make scarce hard currency available to pay for additional imports which they otherwise could not purchase.

Some have suggested that the United States should declare Poland in default of its obligations and satisfy these obligations by attaching its assets.

While the United States could attempt to recover some of the funds it loaned Poland in this way there are, however, virtually no Polish assets. In fact, the court costs involved in such an effort might even exceed the value of the property attached.

In short, we have opted for an approach that is draining resources out of Poland rather than taking what would essentially be a symbolic gesture. And, by not declaring Poland in default and continuing to insist on their meeting their obligations, we are also indirectly bringing additional financial pressure to bear on the Soviet Union -- the real instigator of the repressive regime in Poland. As a result of not declaring a default, the

Soviets are now pressured to provide additional economic resources to keep the Polish economy functioning at some minimally acceptable level and to assist the Poles in meeting their hard currency debt service payments to avoid further damage to Poland, other bloc countries, and the Soviet Union.

I will now comment briefly on the CCC export guarantee program and on CCC's offer to U.S. banks that has also been the subject of much discussion.

When an exporter enters into a guarantee contract with CCC, CCC becomes legally obligated to make payments to the exporter or its assignee bank in the event the foreign importer's bank fails to meet its payment obligations. This obligation is similar to that undertaken in other U.S. Government loan guarantee programs such as the Export-Import Bank's Financial Guarantee Program for exports of manufactured goods. In order for the holder of the guarantee to collect from CCC, the holder must first notify CCC that a payment has been missed and then file a claim together with the necessary supporting documentation. Once the holder of the guarantee has filed its claim with CCC, CCC must then pay the holder the amount of the guarantee. The holder then transfers to CCC the holder's interest in the missed payment. The foreign borrower is in no way relieved of any obligation -- it still owes the identical amount. Only now it must pay CCC for the missed payments and it must continue paying the guarantee holder the remaining payments as they fall due.

I would also like to emphasize that these payments do not mean -- as has been alleged -- that the CCC is bailing out the banks. The banks were certain of being paid. The CCC guaranteed the credits involved. In the absence of Polish payments, the CCC is obligated to honor its guarantees.

Although CCC regulations refer to the notice document as a "notice of default," it in fact is simply a notice of nonpayment. It does not constitute a formal declaration by the holder of the guarantee or by the U.S. Government that the foreign bank is in default. A formal declaration of default in a loan agreement typically involves triggering specific penalty provisions of the loan agreement, including declaring the entire debt to be immediately due and payable, and perhaps increasing the rate of interest charged on the outstanding balance due. A formal declaration may also entitle the loan holder to seize the debtor's assets in an attempt to satisfy the debt.

The key point to be made is that although the underlying credit agreement the exporter has with the foreign bank may permit the exporter to declare a formal default in the event of a missed payment, CCC does not require the guarantee holder to declare a formal default in order to trigger CCC's liability. CCC simply requires prompt notice that a payment has been missed to exercise its obligation to honor its guarantee.

The January 28 offer of CCC to repurchase guarantee obligations it had made to exporters who had extended credits to Poland (or the assignee banks) does not differ substantially from what would happen if the holders filed a notice and claim as provided under CCC regulations. (CCC would discharge its obligations by purchasing the claim rather than have the banks file and then paying.) However, CCC made this offer because of the concern that some of Poland's other official or unofficial creditors might incorrectly believe that the filing of a claim on a CCC guarantee constituted a declaration of default. The January 28 offer is intended to prevent the adverse consequences that could have resulted from an unintended non-CCC declaration of default based on a misunderstanding of the meaning of the notice and claim procedures used by the CCC.

I will be happy to answer any questions which you or other members of the Committee may have.

Attachment

MAR 9 1982

Dear Mr. Chairman:

This is in reply to your letter of March 2, 1982, in which you raised a number of questions relating to the Commodity Credit Corporation's (CCC) export lending activities in Poland. The questions you raised and our responses to them are enclosed.

I trust this is the information you require.

Sincerely,

(Signed) Marc E. Leland

Marc E. Leland
Assistant Secretary
International Affairs

The Honorable
Jesse Helms
Chairman
Committee on Agriculture,
Nutrition, and Forestry
United States Senate
Washington, D.C. 20515

Enclosure

CODE	INITIATOR	REVIEWER	REVIEWER	REVIEWER	REVIEWER	
			2221	5323	[illegible]3	[illegible]313
SURNAME	SHAPIRO	CANNER	GALE	AMMERMAN	MEIGHER	RIEFFEL
INITIAL/DATE	[initials] / 3/9	[initials] / 3/9	/	JA / 3/9	[initials] / 3/9	[initials] Mar 9

TD F 10-01.4 (8-77) replaces OS 3196 (2-75) which may be used

CORRESPONDENCE APPROVAL AND CLEARANCE

(1) Question: Why did the Administration choose not to declare Poland in default?

Answer: We believe that by not declaring Poland in default at this time we are bringing maximum pressure to bear on Poland and the Soviet Union by promoting a continued flow of hard currency from Poland to the West. We still retain the option of declaring Poland in default.

(2) Question: Were the USDA's Commodity Credit Corporation's (CCC) regulations on paying guarantees to the banks adhered to in payment to U.S. banks?

Answer: The January 28, 1982 offer of the CCC to holders of CCC guarantees covering credits to Poland is clearly within the CCC's legal authority and is consistent with the laws and regulations governing the CCC. This conclusion is based on two elements: (1) the January 28 offer in no way alters the basic rights and liabilities of CCC under its obligations but instead offers a possibility of improving CCC's position concerning those obligations, and (2) CCC has broad statutory authority to enter into contracts of this type for the settlement of its claims and obligations.

The regulations that set forth the procedures for payment in connection with CCC's guarantees under the GSM-101 and GSM-102 programs provide that in order for the holder of the guarantee to collect from CCC, the holder must first notify CCC that a payment has been missed and then file a claim, together with supporting documentation. Although the notice document provided for in CCC's regulations is termed a "notice of default," CCC's definition of default for purposes of notification is fundamentally different from the concept of default in banking circles. Moreover, the notice required by CCC's regulations has a different purpose from a declaration of default in the banking context.

Under the CCC regulations, "default" is defined as occurring when a payment by the borrower has been missed. The purpose of requiring the holder of the guarantee to notify CCC that the foreign bank has failed to make a remittance is to alert CCC to its imminent liability for that payment and to allow it to take such actions as it considers appropriate to protect its interests. On the other hand, a formal declaration of default in the banking context commonly involves triggering the penalty provisions contained in the agreement with the debtor, including declaring the entire debt to be due and payable and increasing the rate of interest charged on the outstanding balance due. A formal declaration may also trigger efforts to seize the debtor's assets in an attempt to satisfy the debt. CCC does not require such a declaration of default by the holder in order to trigger CCC's liability. CCC simply requires prompt notice that a payment has been missed. The notice could have as well been styled a "notice of overdue payment" or a "notice of nonpayment". CCC nevertheless made its Janaury 28 offer to guarantee-holders because it felt that other lenders not familiar with the CCC terminology might mistakenly believe that the filing of a "notice of default" with the CCC constituted a declaration of default.

While dispensing with the requirement to file a "notice of default", the January 28 offer otherwise closely approximates the terms on which the CCC would make payment on a claim. The procedural requirements under the offer provide CCC the same protection with respect to its rights and liabilities as the procedural notice and claim requirements of the regulations. Moreover, substantively, the terms and conditions under which CCC made its offer did not alter -- and, in fact, under one option of the offer there was the potential to improve -- the financial position of CCC compared to its position under the original guarantee contract.

As for the second element set forth above, the Commodity Credit Corporation Charter Act, 15 U.S.C. sections 714 et seq. (the "CCC Act"), confers broad authority upon the CCC to manage its fiscal affairs. The CCC, therefore, is not limited to making payments under its guarantees only according to the terms of its regulations. It has sufficient statutory authority to amend the terms of the guarantee contracts without amending its regulations. In exercising this authority, CCC is subject to the duty to act in accordance with customary standards of prudent business management.

Section 4(g) of the CCC Act empowers CCC to "enter into and carry out such contracts or agreements as are necessary in the conduct of business". Section 4(j) gives CCC the power to "determine the character of and the necessity for its obligations and expenditures and the manner in which they shall be incurred, allowed, and paid". Section 4(k) authorizes CCC "to make final and conclusive settlement and adjustment of any claims by or against the Corporation or the accounts of its fiscal officers". Finally, section 4(m) provides that CCC "[s]hall have such powers as may be necessary or appropriate for the exercise of powers specifically vested in the Corporation, and all such incidental powers as are customary in corporations generally". (15 U.S.C. section 714b.)

In making its January 28 offer, CCC was thus using its powers to make and amend such contracts as necessary to the judicious management of its obligations and its powers to settle its claims arising under those contracts. CCC was not obligated to amend its regulations in order to make this offer. Those regulations prescribe the rules and conditions under which CCC is willing to issue its guarantees, but once issued, those guarantees are contracts between the holders and CCC. Like any other contract, the guarantees are subject to amendment by the parties to the contract.

(3) Question: What are the ramifications of declaring Poland and possibly other nations in default under the program?

Answer: The ramifications of declaring Poland and possibly other nations in default under the program would depend to a large extent on the reactions of other governments and private creditors. Other western governments are not obligated to follow the United States in this respect. Private banks would be under no compulsion to declare a default, and they would only have a clear incentive to do so if they expected the U.S. or other governments, as a result of their declarations of default, to obtain a preferred position in any subsequent legal steps against Polish assets. Banks probably would not follow suit if they felt that declaration of default would prejudice their chance of ultimately being paid. Thus, it is conceivable that a declaration of default under the CCC program would not basically alter the status quo.

However, a declaration of default could conceivably trigger the invocation of cross default clauses in private bank loans to Poland. Syndicated or negotiated loans normally carry default and "cross-default" clauses in the loan agreement. These clauses describe when and how the lenders can declare a borrower to be in default. The clauses are not uniform and vary from loan agreement to loan agreement and bank to bank.

A "cross default" clause merely states that a default can be declared on a specific loan if any other loan to the borrower is in default. The invocation of cross default clauses could trigger legal action by creditors in an effort to seize Polish assets, of which there are few in the West. It would also reduce Poland's ability to earn the hard currency necessary to service its debts to the West.

(4) Question: What is the probability of Poland and other Eastern bloc nations' ability to pay for imports of U.S. agricultural goods?

Answer: A nation's ability to import is directly related to its export earnings capabilities and underlying creditworthiness. This, in turn, depends upon such factors as the economic performance of the exporting country, economic developments in the potential importing country, the availability, quality and price of competing goods and the existence or absence of impediments to trade flows. Given Poland's extremely serious financial, economic and debt problems, it is unlikely that they will be in a position to import significant amounts of U.S. agricultural goods in the immediate future. Romania's financial difficulties also raise questions about its ability to import agricultural goods in current circumstances. The other Soviet bloc countries have sufficient hard currency earnings to enable them to purchase U.S. agricultural goods for cash if those governments decide to allocate these funds for that purpose. If they do so, it will reduce the resources they have available for other purposes.

(5) Question: What is the likelihood the United States will be able to obtain repayment from Poland on guarantees paid to U.S. banks?

Answer: In the short run, it is highly doubtful that Poland will pay these obligations in full, although some payments are being made. Over the long run, the likelihood of payment would appear to be <u>much</u> greater. Poland has such basic resources as an educated and technically skilled population, coal, copper, sulphur and other raw materials to earn the foreign exchange needed to pay its debts. As it is in the economic interest of Poland to retain its business and financial ties with the West, it can be expected to make all possible efforts to meet these obligations. Poland has repeatedly indicated its intention to do so, and we will make every effort to pressure Poland to make its payments in full.

(6) Question: Exactly what are the cases this century where foreign governments have defaulted to the U.S. Government, U.S. citizens, and to U.S. corporations? Is the U.S. Government owed money today from any of these cases? Are U.S. citizens or corporations owed money from any of these cases. If money is owed from these cases precisely what are the current amounts due?

Answer: We are not aware of any country that has been formally declared in default by the U.S. Government.

The Office of the Assistant Secretary for International Affairs publishes data semi-annually on foreign indebtedness to the United States Government. One of these publications singles out "Amounts Due and Unpaid 90 Days or More". This information has been compiled since June 30, 1972. In cases of loan agreements with scheduled repayment dates, the 90 days are calculated from the due dates of the incomplete payments. For accounts receivable, the reference point is that date on which repayment is customarily expected. We are enclosing, for your information, a copy of the latest report, which was published September 30, 1981.

The United States Government does not maintain on a regular basis information on amounts due by foreign governments to U.S. citizens or U.S. corporations.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE March 15, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 4,802 million of 13-week bills and for $ 4,802 million of 26-week bills, both to be issued on March 18, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 17, 1982			:	26-week bills maturing September 16, 1982		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.759	12.822%	13.44%	:	93.478	12.901%	13.99%
Low	96.727	12.948%	13.57%	:	93.435	12.986%	14.09%
Average	96.737	12.909%	13.53%	:	93.447	12.962% 2/	14.06%

Tenders at the low price for the 13-week bills were allotted 90%.
Tenders at the low price for the 26-week bills were allotted 92%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 92,090	$ 60,590	:	$ 74,040	$ 53,040
New York	8,673,005	3,697,955	:	9,341,170	3,634,170
Philadelphia	108,180	56,705	:	25,265	25,265
Cleveland	53,330	48,280	:	108,450	88,450
Richmond	48,015	45,000	:	92,575	49,075
Atlanta	50,490	50,455	:	55,985	50,035
Chicago	1,103,770	284,745	:	1,011,505	258,605
St. Louis	38,410	36,410	:	26,510	23,510
Minneapolis	26,715	16,715	:	21,510	13,510
Kansas City	41,025	38,525	:	48,775	48,275
Dallas	31,775	26,775	:	21,295	16,295
San Francisco	448,080	215,980	:	822,230	227,230
Treasury	223,480	223,480	:	314,465	314,465
TOTALS	$10,938,365	$4,801,615	:	$11,963,775	$4,801,925
Type					
Competitive	$ 8,626,165	$2,489,415	:	$ 9,297,200	$2,135,350
Noncompetitive	1,031,670	1,031,670	:	970,075	970,075
Subtotal, Public	$ 9,657,835	$3,521,085	:	$10,267,275	$3,105,425
Federal Reserve	1,147,030	1,147,030	:	1,050,000	1,050,000
Foreign Official Institutions	133,500	133,500	:	646,500	646,500
TOTALS	$10,938,365	$4,801,615	:	$11,963,775	$4,801,925

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.626%.

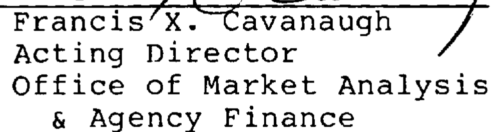
R-674

FOR IMMEDIATE RELEASE MARCH 15, 1982

The Treasury announced today that the 2-1/2 year Treasury yield curve rate for the five business days ending March 15, 1982, averaged 14.10 % rounded to the nearest five basis points. Ceiling rates based on this rate will be in effect from Tuesday, March 16, 1982 through Monday, March 29, 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

03-15

BILLING CODE: 4810-25

DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

Washington, D.C. 20220

COMPTROLLER OF THE CURRENCY
FEDERAL RESERVE BOARD

FEDERAL DEPOSIT INSURANCE CORPORATION
NATIONAL CREDIT UNION ADMINISTRATION

FEDERAL HOME LOAN BANK BOAR
DEPARTMENT OF THE TREASUR

GOVERNMENT IN THE SUNSHINE MEETING NOTICE

Time and Date: 3:30 p.m., March 22, 1982

Place: Cash Room, Department of the Treasury
(Use Pennsylvania Avenue Entrance)
Pennsylvania Avenue between 15th Street
and East Executive Avenue
Washington, D.C., 20220

Status: Open

Matters to be Considered:

1. Election of Chairman and Vice Chairman.

2. Consideration of a plan to deregulate interest rate limitations on time deposits.

3. Consideration of short-term deposit instrument proposals.

4. Consideration of the interest rate ceiling for savings deposits.

NOTE: This meeting will be recorded for the benefit of those unable to attend. Cassettes will be available for listening in the DIDC offices at the Department of the Treasury, and copies may be purchased for $5.00 per cassette by calling (202) 566-5152 or by writing to:

Depository Institutions Deregulation Committee
Department of the Treasury, Room 1054 MT
Washington, D.C., 20220

For further information about the DIDC and the March 22 meeting, please call (202) 566-3734.

Steven L. Skancke -- March 15, 1982

Steven L. Skancke, Executive Secretary of the Committee

TREASURY NEWS

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

For Release Upon Delivery
Expected at 10:00 A.M. EST

STATEMENT OF
THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY FOR TAX POLICY
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON SELECT REVENUE MEASURES
HOUSE COMMITTEE ON WAYS AND MEANS
MARCH 16, 1982

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to present the views of the Treasury Department on the following bills: H.R. 612, 2647, 2981, and 4592, relating to gambling winnings; H.R. 4990, relating to the tax-exempt status of certain amateur athletic organizations; H.R. 4473, relating to rollovers of partial distributions from qualified plans and tax-sheltered annuities to individual retirement accounts; H.R. 3191, relating to the deductibility of expenses of attending conventions on domestic cruise ships; H.R. 4444, relating to the exclusion of research expenses from the capital expenditure limitation for small issue industrial development bonds; H.R. 2597, relating to membership requirements for tax-exempt veterans organizations; H.R. 4577, relating to the effective date for the restricted property provision of the Economic Recovery Tax Act of 1981; H.R. 5630, relating to deferred compensation plans for State judges; and H.R. 1808, relating to transfers of certain imported beer from customs custody to a domestic brewery.

After setting out a summary and the position of the Treasury with respect to these bills, I will discuss the proposals in detail:

Summary

H.R. 612, H.R. 2981, and H.R. 4592 would repeal the requirement for withholding as it applies to gambling winnings and H.R. 2647 would raise the dollar threshold at which withholding begins. H.R. 4592 would also substantially limit the instances in which information reporting on gambling winnings is required and would allow taxpayers to carry a net wagering loss back 3 years and forward 3 years.

Treasury is strongly opposed to any efforts to repeal, or limit significantly, the provisions of current law imposing withholding and information reporting or gambling winnings. In addition, Treasury opposes that provision of H.R. 4592 which would allow a 3-year carryback and carryforward for net gambling losses.

H.R. 4990 would provide that organizations which foster national or international amateur sports competition are entitled to tax-exempt status without regard to their provision of facilities or equipment. Additionally, special limitations on the deductibility of contributions to such organizations are provided.

Treasury strongly supports legislation to clarify this area. However, certain issues remain under H.R. 4990. We would be pleased to assist in fashioning a solution which would balance the interests of all concerned.

H.R. 4473 would allow certain partial distributions from qualified pension, profit-sharing, stock bonus, and annuity plans to be "rolled over" to individual retirement accounts without the payment of current tax. Treasury supports the concept of H.R. 4473. These changes would promote private saving for retirement and would simplify one of the most complex areas of the tax law. Treasury is concerned, however, that the bill may have a negative impact on revenue in the short term and we therefore cannot support this bill at this time.

H.R. 3191 would allow a deduction for business expenses for attending a convention, seminar, or similar meeting aboard a domestic cruise ship to the same extent as other business expenses if all ports of call of the cruise are within the North America area. Treasury is strongly opposed to H.R. 3191.

H.R. 4444 would provide that R&D expenses which the taxpayer elects to deduct under section 174 will not be treated as capital expenditures for purposes of the $10 million limitation on small issue industrial development bonds. Treasury believes that it is inappropriate to make the change effected by this bill without a complete review of the basic issues presented by section 103.

H.R. 2597 would broaden the membership requirements for tax-exempt veterans organizations, to apply the 75 percent veteran membership requirement without regard to whether such service was in war or peace. Treasury opposes H.R. 2597.

H.R. 4577 would make retroactive to 1969 section 252 of the Economic Recovery Tax Act, which permits a taxpayer who receives stock subject to certain Federal securities or accounting law restrictions to include the value of the stock in income when those restrictions terminate. Treasury opposes H.R. 4577.

H.R. 5630 would exempt certain State judicial retirement plans from the disqualification rules of section 457(e)(1). Treasury supports H.R. 5630.

H.R. 1808 would permit certain imported beer to be transferred tax-free from customs custody to a domestic brewery. Treasury opposes H.R. 1808.

* * * * *

H.R. 612, H.R. 2647, H.R. 2981, and H.R. 4592

Repeal, or Substantial Modification, of the Requirements for Withholding and Information Reporting in the Case of Certain Gambling Winnings

Current law provides for information reporting and withholding in the case of the payment of certain gambling winnings. Three of these bills would repeal the requirement for withholding as it applies to gambling winnings. One of these three bills, H.R. 4592, would substantially limit the instances in which information reports are required. This bill would also allow taxpayers to carry net wagering losses back 3 years and forward 3 years. The fourth bill, H.R. 2647, although not repealing withholding, would raise the dollar threshold at which withholding begins.

Present Law

Since 1977, withholding, at a 20 percent rate, has been required in the case of certain gambling winnings. Net proceeds from the following categories of gambling winnings are subject to withholding:

1. Proceeds of more than $5,000 from a lottery conducted by a State agency acting under State law.

2. Proceeds of more than $1,000 from a sweepstakes, wagering pool or lottery, other than a State lottery.

3. Proceeds of more than $1,000 from a parimutuel pool with respect to horse or dog racing, or jai alai, if the betting odds are at least 300 to 1.

4. Proceeds of more than $1,000 from any other wagering transactions if the betting odds are at least 300 to 1.

Winnings from keno, slot machines, and bingo are exempt from the current law provisions for withholding.

In addition to the requirement for withholding, information returns (Forms W-2G) generally must be filed when the winnings from wagering activities exceed $600 and the payout is based on betting odds of 300 to 1, or higher. Although the $600 threshold is provided for by statute, the 300 to 1 odds requirement is a product of longstanding administrative practice. In the case of winnings from bingo or slot machine play, the dollar threshold is set at $1,200 and, in the case of keno, it is set at $1,500. In neither of these cases is there an "odds requirement." When an information return is required, the person receiving the payment must furnish the payor with his name, address, and taxpayer identification number. This information, in turn, must be reported to the Internal Revenue Service.

Under current law, losses from wagering transactions are deductible only to the extent of gains from such transactions in the taxable year. Current law does not permit the carryover of such losses to a later or earlier taxable year.

Proposed Legislation

H.R. 612 and H.R. 2981 are identical bills. Both would repeal the provisions of current law relating to withholding on gambling winnings. They would leave the information reporting requirements intact. The provisions of H.R. 612 and H.R. 2981 would be effective for payments made after date of enactment.

H.R. 2647 would amend the withholding provisions of current law by raising the dollar threshold from $1,000 to $5,000. The betting odds requirement at 300 to 1 would be retained. H.R. 2647 would not modify the information reporting requirements of current law and would be effective for payments made after date of enactment.

H.R. 4592 would repeal the withholding provisions of current law. In addition, it would amend the current information reporting requirement so that reports would be required only where the amount of gambling winnings was $10,000, or greater. In addition to these changes, H.R. 4592 would allow taxpayers to carry a net wagering loss back 3 years and forward 3 years.

Treasury Position

Treasury is strongly opposed to any efforts to repeal, or limit significantly, the provisions of current law imposing withholding and information reporting on gambling winnings. In addition, Treasury opposes that provision of H.R. 4592 which would allow a 3-year carryback and carryforward for net gambling losses.

At the outset, it should be noted that the withholding provisions of current law do not apply to the overwhelming majority of payoffs from wagering transactions. There is not only a dollar threshold requirement (generally $1,000) but also an odds limitation, i.e., the betting odds generally must be at least 300 to 1. Thus, the withholding provisions are directed at those special types of wagers which represent unique and occasional windfalls. These are the cases in which it is reasonable to expect a taxpayer to have significant net gambling winnings for the year and, as a result, a substantial income tax liability. We strongly believe that it is both necessary and appropriate to retain the withholding provisions in those instances.

Secondly, it must be recognized that withholding is an important tool available to the Internal Revenue Service to insure compliance in the reporting of income. Withholding is an element in improving compliance in two respects. First, it provides an incentive for taxpayers who have substantial winnings to report those winnings accurately in order to claim the benefit of the withheld amounts on their income tax returns. Second, withholding provides a means of collecting at least a portion of the tax due from winners who fail to file income tax returns. An Internal Revenue Service study of compliance in the reporting of gambling winnings, mandated by the Tax Reform Act of 1976, concluded that there was a strong correlation between rates of compliance and the presence of withholding at the source. Taxpayers subject to withholding had consistently higher rates of compliance than those subject only to information reporting.

Third, from the viewpoint of tax administration, withholding provides a far better mechanism to ensure compliance than does mere information reporting. Withholding on significant gambling winnings automatically collects a portion of the tax liability attributable to those winnings. This helps to reduce the tax agency's audit and collection workloads. Withholding contributes to the efforts by the Internal Revenue Service to discourage the use of so-called "10 percenters," and similar practices to avoid tracing of significant winnings. Withholding raises the cost to the bettor of using a "10 percenter" because the bettor cannot claim a refund for the taxes withheld. Withholding is also superior to mere information reporting because information reporting requires both accurate information documents and a properly filed income tax return to achieve an acceptable "match," as well as the resources to follow up where there are apparent discrepancies. In the absence of withholding, neither the payor nor the payee has any real incentive to verify the accuracy of the statements made on the information return. Inaccuracies, whether intentional or inadvertent, frustrate the ability to match the documents, and raise the overall cost of tracing gambling winnings to the returns. While information reporting is an effective tool to increase compliance, its combination with a system of withholding is a significant benefit from the standpoint of tax administration.

Finally, some in the industry have argued that the imposition of withholding and information reporting creates an incentive for patrons to wager with illegal bookmakers rather than with legalized and state-regulated wagering establishments. Proponents of this view argue that withholding and information reporting cause the gambling dollars of these bettors to flow to the criminal elements that operate the illegal wagering activity. Furthermore, they argue that legalized establishments whose income is a function of the gross amount wagered are financially disadvantaged by this decrease in the amount wagered.

In our view, this argument proves too much. On careful analysis, one must ask the question why such bettors prefer to place their bets with illegal bookmakers. One natural conclusion is that some, if not a substantial portion, of these bettors must be attempting to avoid the reporting and withholding requirements of current law. It is also logical to assume that these individuals are failing to report this income on their returns. Reduced to its essential points, this argument asks us to condone implicitly a failure to report income by making it easier to win at legalized establishments and not report the winnings. This also provides a net economic benefit to the legalized establishments by allowing them to profit from the winnings which will go unreported. Treasury simply cannot stand by and acquiesce in a change which will encourage, rather than discourage, the failure to report income accurately.

For the reasons set forth above, Treasury strongly opposes the provisions of these four bills which would eliminate, or significantly modify, the information reporting and withholding requirements of current law.

H.R. 4990 -- Amateur Sports Organizations

H.R. 4990 clarifies the tax-exempt status of certain amateur sports organizations. S. 1757, a bill similar in concept but taking a somewhat different approach, has been introduced in the Senate. The Treasury testified on S. 1757 on December 11, 1981.

The Treasury Department strongly supports clarifying legislation in this area. While both H.R. 4990 and S. 1757 would provide this clarification, from a technical standpoint H.R. 4990 would accomplish the objectives in a more direct manner, although there are still several provisions in H.R. 4990 which need further consideration and which we will address. We would be pleased to assist in fashioning a solution to these issues which would effectively balance the interests of all concerned.

To put the issues in perspective, I believe that some background may be useful. Prior to 1976, organizations which were engaged in the teaching of sports or promoting sports for youth generally qualified for tax exemption as educational or charitable organizations under section 501(c)(3) of the Internal Revenue Code and were thereby eligible recipients of tax deductible contributions. However, organizations which were engaged in promoting, governing, and regulating amateur sports but not for youth were generally exempt under section 501(c)(4) or 501(c)(6), with the result that contributions to such organizations were generally not eligible for tax deduction.

The Tax Reform Act of 1976 sought to provide clarification and uniformity in this area. Additionally, Congress considered it appropriate to encourage organizations which contributed to developing athletes for competition in the Olympic games and other national or international competition. Accordingly, section 1313 of the Act created, as a separate category of exempt organization under section 501(c)(3), organizations organized and operated exclusively to foster national or international amateur sports competition. The provision was intended not to affect adversely the qualification of any organization which would qualify under the standards of prior law.

In the development of this provision there was substantial concern that organizations which foster amateur sports could prove to be vehicles through which individuals paid for private recreational activities with tax-deductible dollars. Accordingly, the Conference Committee added as a condition to exemption the parenthetical phrase "(but only if no part of [the organization's] activities involve the provision of athletic facilities or equipment)." Although the legislative history of the 1976 Act indicates that the purpose of this limitation was to prevent qualification for organizations which, like social clubs, provide facilities or equipment to their members, the statute is absolute, stating that any provision of facilities bars exemption. Thus, the effect of the clear provisions of the statute is to prevent exemption, not only for social clubs, but also for other amateur sports organizations.

The existence of this facilities-equipment limitation has created serious administrative problems. Compelled to follow the unambiguous language of the statute, the Internal Revenue Service and Treasury have determined that organizations providing facilities cannot be recognized as exempt, unless the organization could otherwise qualify under section 501(c)(3). As a complicating factor, the Congress in 1978 enacted the Amateur Sports Act, a purpose of which was to coordinate and reorganize amateur sports in this country. The Act requires that the national governing bodies for Olympic sports be incorporated as separate autonomous entities. As a result, a number of former components of the Amateur Athletic Union (AAU) have been spun off and have applied for exemption under the amateur sports provisions. However, as many of these organizations provide facilities and equipment, they could not qualify under the 1976 Act amendments. Further, it was not at all clear that they could qualify under the standards of prior law. This created the ironic situation where, while the AAU was an exempt section 501(c)(3) organization when the 1976 amendments were enacted, the national governing bodies might not qualify for exemption under present law.

The Service and Treasury have been reluctant to take the draconian measure of issuing adverse rulings to organizations providing facilities and equipment. At the same time, however, we have been unable to fashion an approach administratively which would appropriately draw the lines between qualified and nonqualified organizations. Only Congress can provide the solution to this dilemma. In the meantime, numerous applications for exemption are pending at the IRS and Treasury awaiting a solution.

We therefore appreciate the introduction of legislation to solve this problem. As I stated earlier, from a technical standpoint, H.R. 4990 solves the problem in a more direct fashion than does S. 1757. The Senate bill makes certain changes to the exemption section, section 501(c)(3), which defines a qualified organization. The goal of these provisions, of course, is to differentiate organizations which truly foster national or international amateur sports competition from those which are merely for private recreation. This line, however, is a difficult, if not impossible, one to draw. Further, we do not believe it necesssary to make the attempt in the exemption provisions. As we see it, the problem is not one of exemption *per se* but rather the deductibility of the contributions to the organization. We do not anticipate that these organizations will have substantial income. However, we are concerned that individuals will be able to pay for recreational activities with tax-deductible contributions.

In this connection, I should note that some may argue that legislative changes are unnecessary in light of the principle that no charitable contribution deduction is allowed where the donor receives a benefit by reason of the contribution. While this *quid pro quo* doctrine is an important and long-standing principle of law, its reaches are uncertain and it is not easy to apply. While the *quid pro quo* doctrine should continue to apply in this, as well as in other, areas, we believe that certain specific rules, over and above *quid pro quo*, are necessary.

Thus, H.R. 4990 attacks the problem by focusing on the deduction rather than the exemption sections and by providing specific disallowance rules. Under that bill, the parenthetical to section 501(c)(3) would be eliminated, with the result that any otherwise eligible organization which fosters national or international amateur sports competition will be eligible for exemption without regard to its provision of athletic facilities or equipment. However, specific provisions would be added to the income, estate, and gift tax charitable contribution sections which will preclude deduction for contributions to these organizations under certain circumstances. As a general matter, the provision would disallow a deduction to the organization if the contribution is made by a person (or by a member of his or her family) who uses any athletic facility or equipment provided by the organization within a period beginning 12 months before and ending 12 months after the day the contribution is made.

The changes to the section 501(c)(3) rules would be retroactive to the effective date of the 1976 Act. The changes to the contribution rules would apply prospectively to contributions made after December 31, 1981. Thus, contributions made to these organizations in prior years would be allowed without regard to the specific disallowance rules.

H.R. 4990 provides three exceptions to the disallowance rule. The first, intended as a _de minimis_ rule, provides that contributions up to $500 per year will be insulated from the specific disallowance provision. This exception highlights one of the problems in this area. We recognize that there will be cases where a person makes a very small contribution to an organization and he (or a member of his family) makes considerable use of the facilities. In this case, probably no deduction should be allowed. At the other extreme are cases where the donor makes a substantial contribution and uses the facilities to a relatively insignificant extent. In these cases, at least some portion of the contribution should be allowed as a deduction. In between are the vast majority of cases where there is some contribution and some use of facilities. In these cases, it is very difficult to determine the amount, if any, of the contribution which should be allowed. Compounding the problem are the administrative difficulties of measuring, under any of these scenarios, the extent and value of the use, and the limited audit resources of the Internal Revenue Service to make this measurement. While the _quid pro quo_ doctrine is available to handle some of the clearer cases when selected for audit, we believe that a rule is necessary to facilitate administration in other instances.

The approach taken by H.R. 4990 is to provide a strict disallowance rule, barring all deduction when there is use of the facilities, and then providing the _de minimis_ exception. We believe there is considerable merit to this approach. The strict disallowance rule will eliminate the requirement that the Service monitor in every case the extent and value of use, and the _de minimis_ exception carves out those cases where the amounts are small and therefore not of substantial concern. In this connection, however, we think the $500 exception may be too high. Inasmuch as the purpose of the disallowance rule in the first instance is to police the financing of private recreation with deductible contributions, the exception should be limited to relatively small amounts. We would recommend a $200 _de minimis_ exception. Further, I must emphasize that if a _de minimis_ exception is provided (whatever the amount), it _should not_ in any way affect the _quid pro quo_ principle. Thus, even contributions within the _de minimis_ limit would be subject to disallowance if the link between the contribution and benefit to the contributor could be established.

A second exception to the specific allowance rule (also subject to _quid pro quo_) applies to contributions to the U.S. Olympic Committee or to a national governing body. We have no objection to this exception since contributions to these types of organizations were generally allowed under the law prior to 1976 without regard to the provision of facilities or equipment to the contributor or the contributor's family. We agree that a similar rule should now apply.

The third exception applies to non-reimbursed, out-of-pocket expenditures made incident to the rendering of services by a noncompetitor. We are troubled by this provision in that it may be subject to abuse. For example, a parent wanting to watch his or her child participate in an out-of-town athletic competition may arrange to render some nominal service to the sponsoring organization and thereby claim a deduction for the travel and lodging expenses incurred. While this abuse potential is not unique to amateur sports organizations, its impact becomes more acute given the nature of the organization involved and the likelihood of family members incurring the expenses described.

We believe, and we think supporters of the bill would agree, that charitable contribution deductions should not be allowed under these circumstances. Further, we believe that under current law such deductions would not be allowed. Under existing authority, if an out-of-pocket expenditure is made primarily for the personal benefit of the contributor, it is not a deductible contribution. Similarly, with respect to expenses which have a dual character (in that they benefit both the charity and the taxpayer), which are incurred incident to the rendering of services, the presence of a substantial direct personal benefit to the taxpayer or someone other than the charity is fatal to the claim for a charitable contribution. In this area also the legislative history should confirm that the exception is subject to this rule of existing law.

In this connection, I must add that we do not want to limit the deductibility of expenses incurred by the bona fide volunteers of amateur sports organizations. We understand that many organizations depend upon these volunteers as their life blood and we do not want to interfere with that relationship. Our concern is rather with the abusive cases where the service rendered is disproportionate in relation to the expenses claimed.

We strongly support an effort to reach a legislative solution to the problems raised in this area. Accordingly, we would be pleased to assist in fashioning a measure that is satisfactory for all concerned.

H.R. 4473 -- Rollover of Partial Distributions

H.R. 4473 would amend the Internal Revenue Code to allow many partial distributions from pension, profit-sharing, stock bonus, and annuity plans to be "rolled over" to individual retirement arrangements (IRA's) without the payment of current tax.

We support the concept of H.R. 4473. These changes would promote private saving for retirement and simplify one of the most complex areas of the tax law. Treasury is concerned, however, that this bill may have a negative short-term revenue impact and we therefore cannot support this bill at this time.

Under current law a distribution from a qualified plan that meets the technical requirements of a lump sum distribution is entitled to various forms of special tax relief. First, part of the distribution may be eligible for capital gains treatment. Second, if employer securities attributable to employer contributions are included in the distribution, any increase in the value of the securities since their acquisition by the plan is not subject to tax until the securities are sold.

The most recent form of special tax relief for lump sum distributions was provided by the Employee Retirement Income Security Act of 1974 (ERISA) which amended the Code to allow special 10-year forward income averaging. Roughly, this treats the distribution as if it were received ratably over a 10-year period and was the only income earned in each such year. The ostensible purpose of such relief was to mitigate the impact of a progressive tax on individuals who receive extraordinary amounts of income in one year and perhaps to recognize the general applicability of lower marginal rates after retirement.

Since the 10-year forward averaging provision seems to assume that the taxpayer would have little or no additional income in his post retirement years, it is appropriate that a taxpayer who elects this special tax relief not be entitled to additional retirement benefits. Hence, in order to qualify as a lump sum distribution, the distribution must constitute, among other things, a distribution of the total balance to the credit of the employee in all similar tax-qualified plans.

The same requirement of a distribution of the total balance to the credit of the employee applies to tax-free rollovers of distributions from qualified plans. Under the rollover rules, taxpayers receiving lump sum distributions from qualified plans can avoid current tax by "rolling over" the distribution into an IRA or another tax-qualified plan. Tax is payable only as distributions are made from the IRA or other plan.

None of the special forms of tax treatment available to lump sum distributions is applicable to an IRA distribution. Rollovers to IRA's therefore enable a recipient to avoid current tax only if the recipient forgoes favorable forms of tax treatment and retains the plan distribution until retirement years.

A distribution from a qualified plan that does not constitute a lump sum distribution is taxed very differently under current law. Partial distributions are includible in income in the year in which received. They cannot be rolled over to an IRA or to another qualified plan, and they do not qualify for any of the forms of special tax relief available for so-called lump sum distributions. However, a subsequent distribution from the same plan may qualify as a lump sum distribution. That second distribution can then be rolled over and may be eligible for special tax relief.

The current tax treatment of partial distributions is harsh when a substantial partial distribution is received. It can also act as a tax trap for the unwary. This can occur if, for example, the employee terminates employment before full vesting, receives a distribution of the vested balance to his credit, and is reemployed before the nonvested balance to this credit is forfeited. In this case, current law requires that the first distribution be treated as ineligible for special tax treatment and for IRA rollovers. Thus, if the employee has already made an IRA rollover, the employee will be subject to tax penalties on his "excess contribution."

Expanded rollover treatment for plan distributions will eliminate or reduce the problems I have described. This expansion would continue the recent trend of liberalizing the rollover rules. In 1974, when rollovers were introduced, only complete rollovers of all proceeds of lump sum distributions were permitted. However, we have since realized that rollovers which are consistent with the policy of encouraging individuals to save for retirement and to have assets available for their retirement period need not be tied to "lump sum distributions."

Since 1974, the rollover rules have been liberalized to permit partial rollovers, rollovers of proceeds from the sale of property, rollovers of section 403(b) annuities and custodial accounts, rollovers of lump sum distributions received by a spouse upon the death of a participant, rollovers of total distributions that did not meet certain technical lump sum distribution rules, and rollovers of distributions received due to a plan distribution or a sale of a subsidiary or assets.

In 1980, Congress first extended tax-free rollover treatment to one type of partial distribution. An employee who received a distribution from a money purchase pension was allowed to treat the distribution as eligible for rollover even though the employee continued to have an interest in a defined benefit pension plan. However, the employee then lost the benefit of special tax treatment for later distributions from either plan.

We suggest that in light of the substantial retirement plan policies which are served by rollovers, the rollover rules should be still further liberalized. H.R. 4473 is a step in this direction, but additional action is needed. For example, rollover treatment should also be extended to partial distributions received after a plan termination or discontinuation of plan contributions; and to distributions received due to sale of a corporate subsidiary or assets. Rollovers of lump sum distributions are permitted in these circumstances and there is no reason to exclude partial rollovers. However, as provided under H.R. 4473, an employee who rolls over such a distribution should not be eligible for 10-year forward averaging, capital gains treatment, or exclusion of net unrealized appreciation on employer securities attributable to employer contributions with respect to any further distributions from the plan or any other plan that would be aggregated with it under the lump sum distribution rules.

We agree that rollover treatment should not be extended to payments under a life annuity or payments under a term certain annuity for a substantial period because of the abuses which might result. For example, an employee who begins to receive an annuity at age 60 could obtain substantial deferral of tax by rolling over each annuity payment into an IRA. No distributions would be required to be made from the IRA until the participant reached age 70-1/2 and then the amounts which would be required to be distributed would be less than the amounts otherwise includible in the employee's income from the qualified plan. Since the purpose of allowing for tax-favored retirement plans is to provide for retirement savings, we believe a rollover in these annuity situations would be inappropriate since the ultimate beneficiary of the retirement plan might be someone other than the employee or the employee's beneficiary.

We believe that the expanded rollover rules of H.R. 4473 would simplify the law in the area of rollovers and will prevent the harsh results that can now occur.

While we support the concept of H.R. 4473, we are concerned that it may have a negative impact on revenue in the short term and we therefore cannot support this bill until we know what the revenue impact would be. This could occur because partial distributions would otherwise be taxed at an individual's marginal tax rate, as would earnings on the after-tax portion of the distribution. H.R. 4473 will exclude partial distributions that are rolled over from current taxation and will increase the pool of tax-sheltered earnings until IRA distributions begin.

H.R. 3191 -- Deductibility of Expenses of Attending Conventions on Domestic Cruise Ships

Background

The restrictions placed on the deductibility of expenses relating to foreign conventions were first enacted in 1976. At that time, Congress recognized the growing practice among professional, business, and trade organizations to sponsor cruises, trips and conventions during which only a small portion of time was devoted to business activity. The promotional material often highlighted the deductibility of expenses incurred in attending a foreign convention and, in some cases, described the meeting in such terms as a "tax-paid vacation" in a "glorious" location. In short, many taxpayers were attending foreign conventions that were really thinly-disguised vacations and then deducting these personal vacation expenses as business expenses. Deductions for attending foreign conventions had thus become a source of tax abuse.

In response to the problem, Congress adopted rules which allowed the claiming of deductions for two conventions per year if the primary purpose for the trips was business and not pleasure. These rules did not eradicate tax-subsidized vacations, however, and were therefore supplemented in 1980 with a "reasonableness" test.

Under this test, the expenses of attending a foreign convention, seminar, or similar meeting are not deductible unless it is more reasonable to hold the convention outside the North American area than within it. The factors to be considered in determining reasonableness of the convention site are: the purpose and activities of the convention; the purpose and activities of the sponsoring organization; the residence of active members of the sponsoring organization; and the places at which other meetings of the sponsoring organization have been held.

For example, if a significant portion of an organization's members resided in France, it could be considered more reasonable for the organization to hold a convention in France than in the United States. Similarly, if the members of an organization composed of individuals engaged in a certain type of business regularly conducted a portion of their business in Germany, it could be considered more reasonable for the organization to hold a convention in Germany than in the United States.

H.R. 3191

Under the present statute, a convention held on any cruise ship is not considered as satisfying the reasonableness test and no deduction is allowed in connection therewith. H.R. 3191 would modify this rule and permit the deduction of attending a convention, seminar, or similar meeting held on a domestic cruise ship if all ports of call of such cruise are inside the North American area. A domestic cruise ship is defined to mean any cruise ship documented under the laws of the U.S.

Treasury is strongly opposed to H.R. 3191.

The reasonableness test adopted in 1980 was intended to deal with the primary problem with foreign conventions, namely, the selection of the foreign site because of vacation motives without regard to business considerations. Even though a convention benefits a taxpayer's business to some degree, there is no justification for a tax deduction where the convention is held at a foreign site having nothing to do with the taxpayer's business. In such cases the personal benefit predominates.

We think this reasoning is sound and applies particularly to conventions held aboard cruise ships. The only reason for holding a convention or seminar on a cruise ship would be for personal enjoyment. It would be a rare case where a cruise has any connection with the topic of the convention or with the organization. In short, we think allowing a deduction for expenses of attending a convention aboard a cruise ship would too closely resemble a tax-subsidized vacation. It is the type of deduction that discredits our entire tax system.

H.R. 4444 -- Capital Expenditures Limitation on Small Issue Industrial Development Bonds

Under present law, interest on IDBs is generally not exempt from Federal income tax since the bond proceeds are used in a private trade or business and payment of the bonds is derived from the business. Exceptions are provided, however, for certain quasi-public "exempt facilities" (such as airports) and for certain "small issues." The small issue exception applies to single issues of $1 million or less, if the bond proceeds are used for land or depreciable property.

At the election of the issuer, the $1 million cap may be increased to $10 million, provided that all outstanding exempt small issues plus other capital expenditures (not financed out of exempt small issues) within a 6-year period with respect to the business project are aggregated for purposes of the limitation. This $10 million cap on the aggregate of prior issues and capital expenditures has the effect of denying tax-exemption to IDBs used in connection with large and expensive projects.

Under Treasury regulations, the amount of capital expenditures is determined under the usual tax rules for distinguishing capital charges from currently deductible expenses. Thus, the research and development cost of developing a new formula, product or other capital asset with respect to the IDB project are capital in nature and now count against the $10 million cap.

H.R. 4444 would alter this result. It would provide that R&D which the project user elects to deduct currently under section 174 would not be counted as capital for IDB purposes. Section 174, of course, was originally enacted _not_ to change the general characterization of R&D from capital to noncapital, but only to allow otherwise capital R&D expenses to be treated in effectively the same manner as ordinary deductible expenses.

Even though R&D generally is capital in nature, we believe that the proposal to treat it as noncapital for IDB purposes has some merit. The interaction of the R&D rules and the section 103 small issue requirements could, in some cases, have the effect of creating an inequitable bias against R&D-intensive firms desiring to make use of the small issue exemption.

Given this background, we must balance the perceived need to encourage R&D activities against tax policy considerations which militate against creating an exception to the general Code treatment of R&D as capital in nature. We must also recognize that we are not writing on a clean slate. Substantial tax incentives for R&D were enacted as part of the Economic Recovery Tax Act of 1981. Finally, we must consider the appropriateness of piecemeal change to the tax rules governing IDBs -- an area fraught with numerous and very basic unresolved questions. A comprehensive reexamination of this area by Congress is clearly in order. We are therefore of the view that it is inappropriate to make the change effected by this bill in the absence of a complete review of the basic issues presented by section 103.

In addition, several technical points should be stressed. First, it is not clear whether the bill applies only to items such as labor and supplies, or whether it also applies to capital R&D equipment and leased quipment. H.R. 4717, passed by the Senate in December of last year, applies only to labor and supplies and we think it is a sound rule. Second, H.R. 4717 has, properly in our view, delimited the scope of permissible R&D expenditures in one other way: The exclusionary rule is not extended to contract research expenses. Particularly in light of the substantial tax credit for such expenditures and current budgetary constraints, we feel that this limitation is appropriate. Third, we think any new rule should only apply to R&D expenditures made after the date of enactment. H.R. 4444 provides for retroactive change of treatment and is deficient in that regard.

H.R. 2597 -- Membership Requirements for Veterans Organizations

Since 1969, Code section 501(c)(19) has granted tax-exempt status to certain groups of veterans. In order to qualify for such status, the group must be composed of at least 75 percent war veterans. The remaining 25 percent must be substantially composed of veterans (other than war veterans), veterans' widows or widowers, and military cadets. A war veteran is defined by the regulations as any person who served in the U.S. Armed Forces during a period of war (including the Korean and Vietnam conflicts).

Prior to the enactment of section 501(c)(19) in 1972, the veterans organizations generally qualified for exemption as social welfare organizations under section 501(c)(4) or as social clubs under section 501(c)(7). This special category of exemption was created to allow veterans organizations more advantageous treatment with respect to their unrelated business income from the sale of insurance coverage. Qualifying veterans organizations are exempt from unrelated business income tax on any amounts attributable to payments for life, sick, accident or health insurance coverage with respect to members or their dependents, provided that such amounts are set aside for purposes of providing for the payment of insurance benefits or for a qualified charitable purpose.

The problem faced by these organizations is that the combination of a prolonged period of peace and the natural attrition rate among surviving war veterans is rapidly reducing the percentage of "war" veterans in section 501(c)(19) organizations. H.R. 2597 would amend the membership test of section 501(c)(19) to provide tax exemption for an otherwise qualifying organization, provided that at least 75 percent of its members are past or present members of the U.S. Armed Forces, without regard to whether these veterans had served during a period of war.

Treasury opposes H.R. 2597 because we oppose any expansion of a rule which exempts from subchapter L (dealing with the taxation of life insurance companies) an organization which engages in the life insurance business at a time when the taxation of life insurance companies is under active study by the Treasury Department.

H.R. 4577 -- Transfers of Restricted Stock

Prior to ERTA, any taxpayer who received stock subject to section 16(b) of The Securities Exchange Act of 1934, (under which an "insider's" profit may be recovered by a corporation if the stock is sold within 6 months of receipt), was required to treat the value of the stock (less any amount paid) as compensation when received.*/ Section 252 of ERTA revised this rule, on the theory that restrictions on transferability which are mandated by Federal securities laws or accounting principles should be taken into account in determining the time in which the value of the stock should

*/See Horwith v. Comm'r, 71 T.C. 932 (1979).

be included in income. After ERTA, any taxpayer who receives stock subject either to section 16(b) or to the "pooling-of-interest" accounting rules will be treated as being subject to a substantial risk of forfeiture within the meaning of Code section 83 for the 6-month period during which the mandated restrictions apply. Thus, the employee will include in income, and the employer may deduct at the time the restriction lapses, the difference between the value of the stock at that time and the amount paid for the stock (if any). This provision applies to transfers after December 31, 1981.

H.R. 4577 would make the above-described change in the restricted stock transfer rule retroactive to June 30, 1969, provided that any person who received restricted stock after that date elects the tax deferral. The same effective date appeared in the original version of this amendment to the restricted property rules, section 810 of H.R. 4242. Under this original proposal, any individual who had received restricted stock in the latter half of any year after 1968 could elect to defer tax liability on the value of the transferred property from the year of receipt until the next year (when the restriction lapsed). The original proposal did not, however, provide for any adjustment in the corresponding business expense deduction of the employer, which under the principles of section 83 should be claimed in the same year the property is taken into income by the employee. The statute of limitations would prevent any adjustment in returns filed up to 14 years prior to the time of an employee's election, thus defeating the correlation between employer deduction and employee inclusion that is mandated by section 83. When this provision appeared in the Conable-Hance II bill, it was given prospective effect only. It was this version which was supported by Treasury and which ultimately became law.

Treasury continues to oppose any retroactive application of ERTA's change in the restricted property rules. This opposition is consistent with our general oppostion to retroactivity even where, as here, the substantive change in the law is sound.

There are additional reasons why retroactivity is inappropriate in this case. First, by going back to 1969, the bill would permit taxpayers to elect to open years closed by the statute of limitations. The purpose of a statute of limitations is to prevent both the Internal Revenue Service and taxpayers from reopening issues after a certain period of time regardless of how meritorious the position may be. This

legislation would clearly violate that rule. Secondly, the bill does not simply apply the new rule to past years. Rather, it provides taxpayers with the option of applying either the old rules or the new rules. Such an optional substantive rule does not represent sound tax policy.

For these reasons, Treasury opposes H.R. 4577.

H.R. 5630 -- State Judicial Retirement Plans

Section 457, as added to the Code by the Revenue Act of 1978, generally permits employees of a state or local government to defer compensation under an eligible state deferred compensation plan, if the deferral does not exceed $7,500 or 25 percent of compensation. Amounts of compensation deferred under an eligible plan, plus interest thereon, are includible in the income of the participant or the participant's beneficiary only when paid or made available under the plan (*e.g.*, upon the participant's separation from service).

If a deferred compensation plan fails to meet the requirements of an eligible plan, section 457(e)(1) provides that all compensation deferred under this ineligible plan after January 1, 1982 will be included in income for the first year in which there is no substantial risk of forfeiture. Section 457(e)(2) lists five exceptions to this broad inclusion rule, encompassing plans that are governed by other retirement rules set forth in the Code. These exceptions are: (1) a qualified plan which includes an exempt trust; (2) a section 403 annuity plan or contract; (3) a qualified bond purchase plan; (4) a section 83 arrangement; and (5) a nonqualified but funded trust.

This statutory list of exceptions does not include certain regular but unfunded state retirement plans -- *i.e.*, plans that provide benefits solely by periodic appropriations by the state legislature from the state's general fund. Participants in all such regular state retirement plans are therefore facing current taxation of amounts deferred under the plan as of January 1, 1982, when section 457 took full effect.

It is clear from the legislative history of section 457 that unfunded regular retirement plans of a state were not intended to be disqualified by section 457(e)(1) (notwithstanding the limited exceptions provided by section 457(e)(2)). See H.R. Rep. No. 95-1445, 95th Cong., 2d Sess.

57 (1978); S. Rep. No. 95-1263, 95th Cong., 2d Sess. 70 (1978). The fact that the legislation was prompted by the Service's position under Prop. Reg. § 61-16, pertaining to compensation deferred under an individual option, and the fact that the statute speaks in terms of an agreement for deferral, provide further indication that Congress did not intend to disqualify those mandatory unfunded state retirement plans that provide no opportunities for individual salary reduction arrangements.

The proposed regulations under section 457 (issued on December 29, 1980) requested comments with respect to whether regulations could appropriately be drafted to exclude unfunded regular retirement plans from the current taxation rule of section 457(e)(1). However, given the clear and unambiguous language of the statute, Treasury and the Internal Revenue Service have been unable to justify drafting a regulatory exception which would accomodate certain unfunded state retirement plans but which would not exclude from section 457(e)(1) those ineligible plans that properly belong within its scope.

Pending clarification of the status of all unfunded state retirement plans, Treasury has provided in its proposed regulations under section 457 that the income inclusion rule of section 457(e)(1) will apply only to compensation deferred under these plans after December 31, 1981. (See Prop. § 1.457-3(c).) The final regulations under section 457 can be expected to contain the same rule. As a result, participants in these unfunded state retirement plans will not be penalized as of January 1, 1982, by the current inclusion in income of all amounts deferred under these plans during the 1978-81 transitional period.

H. R. 5630 provides statutory clarification of the unfunded state retirement plan issue only for certain plans covering state judges. Specifically, the bill exempts certain qualified state judicial plans from the income inclusion rule of section 457(e)(1), provided that such a plan meets the following requirements:

(1) has been in existence continuously since 1978;

(2) requires 100 percent participation by eligible judges;

(3) bases contributions on a uniform fixed percentage of compensation;

(4) includes no salary reduction options;

(5) provides retirement benefits for each judge equal to a percentage of the compensation of all judges of the state holding similar positions (Texas provides for a deferral of 6 percent of judges' compensation); and

(6) pays no benefits in excess of the section 415(b) limits.

A seventh requirement, which would have prevented judges participating in the plan from being eligible to participate (on the basis of judicial service) in any other state deferred compensation plan that qualifies under section 457, appeared in S. 1855 and in H.R. 4881, the original version of H.R. 5630, but has recently been deleted from this bill.

Treasury supports H.R. 5630, based upon our recognition that certain state unfunded plans were not intended to be covered by the section 457(e)(1) disqualification rules. We would also recommend, however, that Congress make a future attempt to exempt from section 457 other state unfunded retirement arrangemuents which are <u>not</u> judicial plans, but which are also unfairly disadvantaged by section 457(e). This broader exception, which would apply generally to regular state retirement plans, should cover any defined benefit pension plan established and maintained by a state (or by a political subdivision, agency, or instrumentality of a state) for the exclusive benefit of state employees, even if the plan is unfunded, provided that --

(1) the plan has been continuously in existence since December 31, 1978;

(2) the plan benefits a significant number of employees, all of whom are similarly situated;

(3) all employees eligible to benefit under the plan are required to participate, and, if contributions to the plan are required, to contribute the same fixed percentage of their basic or regular rate of compensation under the plan;

(4) the plans applies uniform retirement methods to determine the accrued or vested benefits of participants under the plan;

(5) the plan cannot pay benefits with respect to any participant which exceed the limitations on benefits permitted under tax-qualified plans; and

(6) the plan provides no option to plan participants as to contributions or benefits the exercise of which would affect the amount of any participant's currently includible compensation.

H.R. 1808 -- Tax-Free Transfers of Imported Beer

Present law provides separate excise tax rules for domestic and imported beer. Domestically produced beer is subject to a $9 per barrel excise tax ($7 per barrel for certain small producers) at the time the beer is removed from the brewery for consumption or sale. Imported beer is subject to a $9 per barrel tax at the time the beer is removed from customs custody, even if the beer is then transferred to a domestic brewery.

H.R. 1808 would change the point of imposition of the excise tax on imported beer from the point of removal from customs to the point of sale from the brewery, in the case of any beer brought into the United States in bulk containers. Because bulk beer can be stored indefinitely and transferred (either in the pressured containers or by pipeline) tax-free between producers and bonded warehouses, this bill could provide a lengthy deferral of excise tax liability for all beer imported in these containers. Treasury understands that very few domestic brewing companies currently import beer in pressurized bulk containers for bottling in the United States. The bill would place these few with the capability of importing container beer at a competitive advantage relative to those importers that will continue to be liable for excise taxes at the point of removal from customs custody. Treasury believes that the beer excise tax should continue to be imposed uniformly on all importers of beer at the point of removal from customs custody, and therefore opposes H.R. 1808.

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I would be pleased to answer any questions you may have.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. March 16, 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 $9,600 million, to be issued March 25, 1982. This offering will provide $ 350 million of new cash for the Treasury, as the maturing bills were originally issued in the amount of $9,255 million. The two series offered are as follows:

91 -day bills (to maturity date) for approximately $ 4,800 million, representing an additional amount of bills dated December 24, 1981, and to mature June 24, 1982 (CUSIP No. 912794 AU 8), currently outstanding in the amount of $ 4,715 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 4,800 million, to be dated March 25, 1982, and to mature September 23, 1982 (CUSIP No. 912794 BM 5).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing March 25, 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 $1,946 million, and Federal Reserve Banks for their own account hold $3,110 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 $ 1,444 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, March 22, 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 three decimals, e.g., 97.920. 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 March 25, 1982, in cash or other immediately-available funds or in Treasury bills maturing March 25, 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 IMMEDIATE RELEASE
March 17, 1982

Sale of Chrysler Defense to General Dynamics

On March 15, 1982, the members of the Chrysler Loan Guarantee Board approved the sale of Chrysler Defense, Inc., a wholly-owned subsidiary of the Chrysler Corporation, to General Dynamics, Inc. for approximately $335 million dollars. By selling this subsidiary Chrysler improves it's cash position and strengthens it's ability to conduct business in a sagging automotive market.

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TREASURY NEWS

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

For Release Upon Delivery
Expected at 10:00 a.m., EST

STATEMENT OF
THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY
BEFORE THE SENATE COMMITTEE ON THE BUDGET
March 17, 1982

Mr. Chairman and Members of this Committee:

I am pleased to be here today to discuss tax expenditures. As I think everyone would agree, there are many provisions of the Internal Revenue Code specifically designed as incentives to encourage selected economic activities. These special tax provisions are commonly referred to as "tax expenditures," and I will therefore use this term in my testimony today. However, it should be noted that the label "tax expenditure" is misleading. Special tax provisions are not equivalent to direct Government expenditures on goods and services. Direct expenditures involve the purchase of labor, capital, and materials that are used directly by the Government to achieve public goals, such as national defense. In contrast, most special tax provisions provide a subsidy to an activity carried out in the private sector. For this reason, the label "tax subsidies" may better describe these special tax provisions than does the more conventional term "tax expenditures." But even the label "tax subsidies" is misleading, for many special tax provisions simply reduce disincentives in our tax Code. This is particularly true in the case of special tax provisions which have the effect of reducing the double taxation of corporate income.

The Administration is opposed to attempts to legislate blanket, across-the-board limitations on tax expenditures. Such limitations do not account for the different, sometimes highly-desirable, effect of different tax expenditures. Instead, this Administration is committed to a reevaluation of all Government activity in the economy, whether that activity is undertaken through direct outlay and subsidy programs, loan and loan guarantee programs, regulations, or through tax expenditures. Resources can be allocated to achieve public goals by each of these methods, and they must therefore be evaluated. But, that

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evaluation must deal with each program, regulation, or tax provision individually on its own merits. For example, a review of Government energy policy would be incomplete unless it covered energy tax expenditures (such as expensing of exploration and development costs, the excess of percentage over cost depletion, and various energy credits, which will total $8.8 billion in FY 1983), energy loan and loan guarantee programs (which will total $9.4 billion, net, in FY 1983), the cost of energy regulations (for example, price controls on natural gas and the 55 MPH speed limit, for which cost estimates are not included in the Budget), as well as direct outlays for energy (which will total $4.2 billion in FY 1983).

For Government management purposes, it is essential that the resource cost of Government programs be comparably measured, regardless of the particular method by which the allocation of resources is accomplished. The concept of tax expenditures was developed to provide such comparability between programs effected through special tax provisions and programs effected through other methods. Properly defined, measured, and applied, therefore, the tax expenditure concept can serve as a very useful management tool. Like many other concepts, however, it is subject to misuse as well as misunderstanding, and therefore has received some well-founded criticism.

In my remarks today, I will review the definition and measurement of tax expenditures, as well as some of the related concepts and measures that have been confused with tax expenditures. I will discuss the relative efficiency of tax expenditures as a method of achieving public goals. I will also discuss the control of tax expenditures under the Budget Act.

Defining Tax Expenditures

Section 3 of the Budget Act defines tax expenditures as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." This definition requires a distinction to be drawn between the special provisions of the tax structure, which are designed to to achieve public goals, and the normal provisions, which are necessary to make the tax system operational. Obviously, there are different ways to draw this distinction, a point to which I will return later. What follows, then, is the Administration's view of how this distinction should be drawn.

The normal provisions of the income tax include the definition of income subject to tax and allowable deductions, including some provision for the recovery of the cost of depreciable assets; taxable units and their threshold levels of

taxability; the relationship between the taxation of corporations and their shareholders; the schedule of tax rates; the basic tax accounting rules, including the accounting period for taxation and whether income is taxed as it is realized or as it accrues; the treatment of international transactions; and the system of tax administration. Unlike the special tax expenditure provisions, these normal provisions are essential to the income tax.

In our view, for a provision to be special, two conditions must be met:

- The provision must apply to a narrow class of transactions or taxpayers; and
- There must be a general provision to which the special provision is a clear exception.

Some examples of tax expenditures, from Special Analysis G of the Budget, will illustrate this definition.

Under the general provisions of the income tax code, interest received from any source is includable in income subject to tax. However, a special provision allows interest on obligations of State and local Governments to be excluded from taxable income. The exclusion is therefore considered a tax expenditure intended to reduce the cost of borrowing for State and local Governments, even though some of the benefits accrue to lenders. A second example is the statutory exclusion of certain fringe benefits, such as employer-paid medical insurance premiums, from the taxable income of employees. The inclusion of wages in the tax base is a normal rule of the tax Code, and the exclusions of these fringe benefits are special provisions, and therefore constitute tax expenditures. Other examples of tax expenditures include special provisions that promote homeownership, exports, and employment of the handicapped.

Several features of the tax expenditure concept should be noted.

<u>First</u>, while the distinction between the normal and special provisions of the income tax may be clear in the abstract, in practice there is always difficulty in applying the distinction in order to delineate tax expenditures.

<u>Second</u>, the definition of tax expenditures should not be taken to suggest that the normal tax provisions involve no tax incentives or disincentives. All existing taxes affect economic incentives to some extent, and therefore the level and allocation of resources. In fact, some of the normal provisions of the income tax have effects very similar to special provisions.

A good example of this similarity is provided by the Accelerated Cost Recovery System (ACRS) rules and the investment tax credit. Any income tax requires a set of rules for determining how the cost of depreciable assets is recovered. The ACRS provisions now constitute the general income tax rules for that purpose. To see this, one need only ask: If ACRS is "special," what is the "general" rule in the Internal Revenue Code governing the recovery of cost of depreciable property to which ACRS is an exception? Absent some other general provisions, the ACRS provisions must be treated as part of the normal tax structure and therefore do not constitute a tax expenditure. In contrast, the investment credit _is_ considered a tax expenditure because, unlike ACRS, it does not deal with one of the basic structural elements of an income tax.

Third, as I noted previously, there are other possible definitions of tax expenditures. It has often been suggested that tax expenditures be defined relative to the standard of an "ideal" income tax. However, there is no consensus among tax experts on the structure of an "ideal" tax relative to which special (tax expenditure) provisions could be delineated, and few would seriously regard an "ideal" tax as a practical tax structure. For example, under an "ideal" income tax, the rental value of owner-occupied housing would have to be added back (imputed) to homeowners' money income to arrive at the "ideal" income tax base. In addition, using an "ideal" income tax as a standard the double taxation of dividends at the corporate and individual levels would constitute a _negative_ tax expenditure.

The more common approach to tax expenditures has simply been to list possible "tax reform" items. This approach has led to much confusion about the concept and measurement of tax expenditures. Further, neither the "ideal tax" or "tax reform" approaches has the pragmatic advantage of the definition used here and in Special Analysis G of identifying those provisions of the Internal Revenue Code that deal with basic structural features of the income tax, and those that provide special exceptions to those structural rules.

Fourth, the fact that a provision is a tax expenditure under this definition says nothing about the desirability or the effectiveness of the provision. This is also true, it should be noted, for direct outlay programs. The definition (and measurement) of tax expenditures is not a substitute for the analysis and evaluation of programs implemented through the tax system any more than a listing of direct outlays by program is a substitute for their evaluation. Further, the designation of a provision in the income tax Code as "normal" does not imply that the provision is desirable.

Clearly, there are many tax expenditures that serve desirable purposes in an efficient manner. The investment credit provides investment incentives for economic growth. The special tax treatment afforded pension savings, including IRA's and Keogh's, provide important incentives to save. Note that these provisions were expanded by the Economic Recovery Tax Act of 1981.

It is also clear that there are some undesirable tax expenditures and the Administration has proposed to repeal or modify them. Specifically, under our tax proposals the business energy tax credits would be repealed, corporations would be required to capitalize and amortize construction period interest and taxes on commercial structures, and certain restrictions would be placed on issues of tax-exempt bonds for private activities.

In addition to repealing or revising certain tax expenditure provisions, however, the Administration has proposed, for example, to revise the modified coinsurance provision, which has never appeared on any official list of tax expenditure items. Similarly, the special treatment of tax straddles, which was extensively revised by the Economic Recovery Tax Act of 1981, was never listed as a tax expenditure. The fact that these provisions have not been listed as tax expenditures well-illustrates the confusion that has arisen from considering tax expenditures as a list of "tax reform" items. The tax expenditure concept is a tool for budget review and analysis; tax policy review and analysis, on the other hand, need not and should not be limited to an examination of some, rather than all, of the provisions of the income tax Code.

Measuring Tax Expenditures

Tax expenditure estimates are intended to show the cost of resource allocations caused by special tax provisions. To insure comparability between tax expenditure estimates and direct outlay estimates, tax expenditures must be measured in the same manner as are direct outlays. This requires that specific conventions be followed in measuring tax expenditures.

First, as with budget outlay estimates, tax expenditure estimates are made on the assumption that all other provisions of the tax Code and all other laws governing market exchanges are unchanged. The same levels of aggregate income and economic growth that underlie direct outlay estimates are also assumed.

Second, tax expenditure and direct outlay estimates are both based on the actual level of activities given the program; neither estimates what the level of the activity would be in the absence of the program. This is a particularly important point in the case of tax expenditure estimates, because they are often incorrectly assumed to be estimates of the revenue that would be gained if the special tax provision were repealed.

Because of behavioral changes that may follow the repeal of a special tax provision, the revenue gain from repeal may be much lower than the tax expenditure estimate. An example would be the taxation of a particular employee fringe benefit which is currently untaxed, such as employer-paid medical insurance premiums. The expected response would be a decrease in the amount of employer-paid medical insurance premiums, but an increase in the amount of other still untaxed fringe benefits, such as employers' pension contributions and educational assistance. Thus, the revenue gain from the change would be less than the tax expenditure estimate, which only measures, quite correctly, the reduction in tax receipts from the actual level of employer-paid medical insurance premiums in the particular year. Note that there would be analogous behavioral responses if many direct outlay programs were eliminated or curtailed. For example, the removal of a price support for a particular agricultural commodity could be expected to lead to somewhat higher production of other, price-supported, commodities. In such cases, the net reduction in budget outlays would be lower than the savings from the eliminated (or curtailed) program.

A second reason for the difference between revenue gains from repeal of provisions and tax expenditure estimates is the effect repeal would have on the aggregate level of income and economic growth. For example, all receipts as well as expenditure figures in the Budget are based on projections of income and growth which assume the investment tax credit, as currently enacted, will continue to operate. If, however, the investment credit were repealed (or curtailed) without being replaced by a comparable investment incentive, the current projections of income and growth would have to be revised downward. Consistent with these revisions, receipts and expenditure projections would also have to be revised. The estimated net effect of repeal of the investment tax credit on receipts, therefore, would not be equivalent to the tax expenditure estimate shown in the Budget.

Third, comparability with direct outlay estimates requires that tax expenditures be measured as "outlay equivalents." Most outlays in the Federal Government are measured in pretax dollars. That is, the outlay of the Federal Government is taxable income to someone. Tax expenditures directly return income in the form of after-tax dollars in most cases. That is, a tax credit of $10 is a subsidy of $10 after taxes. The measurement of tax expenditures in outlay equivalent form converts the after-tax dollars that the subsidy directly gives rise to into a pretax equivalent amount. For example, in the case of the $10 credit, if the average tax rate of recipients of that credit were 20 percent, the outlay equivalent of the $10 credit would be $12.50. If a $12.50 payment were made in place of the credit, the tax would be $2.50 leaving $10 after tax, the same amount as the credit.

In addition to following these measurement conventions, adjustments must be made for the interactions between various tax expenditure provisions in order to make total tax expenditure estimates by budget function. These interactions may be demonstrated by comparing the result of deleting two tax expenditures simultaneously to that of deleting them separately.

In some cases, the reduction in tax expenditures from the deletion of two items simultaneously would be greater than the sum of the reductions from the deletion of the two items separately. This increase is due to "stacking" of the two items when they are taken together. For example, if interest income from State and local Government bonds were made taxable and capital gains on home sales were not deferred, more individuals would be pushed into higher tax brackets than if just one of these sources of income were treated under the normal rules of the tax Code; the combined reduction in tax expenditures would be greater than the sum of the two separate effects.

In other cases, the reduction in tax expenditures from the deletion of two items together would be smaller than the sum of the reductions considered separately. For example, if the deductibility of mortgage interest payments and homeowner property taxes were both repealed and the zero bracket amount (standard deduction) were left unchanged, more individuals who now itemize their deductions would opt for the zero bracket amount than if only one preference were repealed. The reduction in tax expenditures would therefore be lower from repealing both preferences together than the sum of the two estimates obtained from repealing each one separately.

Total tax expenditures for each functional category, such as national defense and energy, are shown in this year's Budget. In making the estimates, all of these interaction effects were taken into account. Note, however, that the Budget does not present a total of tax expenditures for all functional categories combined. This omission is not due to an inability to take all interactions into account for purposes of such a total. Rather, the omission is due to the fact that such a total carries little meaning. As noted above, tax expenditure estimates are based on the assumption that the programs are in place and that the level of aggregate income and growth are unchanged. These assumptions would clearly be wrong if all tax expenditure provisions were repealed. Further, tax expenditures represent only one method by which Government allocates resources in the economy to achieve public goals; a total for any particular method in isolation is therefore not very useful for Budget review and analysis.

There is one other aspect of the measure of tax expenditures that should be noted. Tax expenditure estimates are measures of the difference between the cost of resources allocated under current law and the cost of the allocation which would take place

under the assumption that each tax expenditure provision had never been in effect. The estimates, therefore, generally show larger amounts than would be saved in the first years of transition to a tax law without one of the special provisions. This is analogous to the "phase-out" likely to accompany reductions in outlay programs as previously authorized and appropriated funds are spent.

Relative Efficiency of Tax Expenditures

Several factors must be considered to determine the efficiency of tax expenditures relative to other methods the Government uses to allocate resources in the economy to achieve public goals. Separate from the determination of the relative efficiency of methods, of course, a determination must be made of whether each program serves a useful public goal. Furthermore, there should be no illusion that somehow programs effected through the tax system are "cheaper" than other programs. This is one reason why it is so important to measure tax expenditures on an "outlay equivalent" basis. I will simply assume in the following that the usefulness and cost determinations have been made.

One consideration in choosing a method to implement a program is the level of Government administration required for the program to be effective. If little or no Government administration is required, and other conditions described below are met, the program might efficiently be designed as a tax expenditure. An example of such a program is the investment tax credit. However, if a high level of Government involvement in the program is required, such as is true, for example, of many agricultural programs, a direct outlay program may be far more efficient.

A second consideration is the specific design of tax expenditure programs. Because of the graduation of income tax rates, an exclusion or deduction has more value to a high-bracket taxpayer than to a taxpayer in a lower bracket. This is the reason, for example, that some of the benefits of the exclusion of interest on State and local bonds accrues to lenders, as I noted earlier. Credits, on the other hand, are of equal value to all taxpayers. Thus, generally, tax expenditure programs are more efficiently designed as credits, rather than as exclusions or deductions.

Third, the relative efficiency of a tax expenditure may depend on the group or activity which is to receive the subsidy. For example, many low-income individuals have no taxable income and therefore could only benefit from a tax credit if it were refundable. Further, to receive the refundable credit they would have to file an income tax return, which many would not otherwise have to do. A direct outlay or other program might therefore be a much more efficient way to reach such groups.

Fourth, it must be remembered that the normal provisions of the income tax Code interact with, and therefore affect the value of, tax expenditures. For example, an across-the-board rate cut changes the value of, i.e., the subsidy provided by, many tax expenditures. If a stable subsidy, or one that should not depend on tax rates and other features of the tax structure, is required for the efficient operation of the program, the program should not be framed as a tax expenditure.

A final consideration is that there is a hidden, although very real, cost involved in burdening the tax system with too many subsidy programs. Tax expenditures complicate the tax system for taxpayers and the Internal Revenue Service, and contribute to the view (whether or not well founded) that the tax system is "unfair." These compliance and perceived equity costs should be included in any assessment of the relative efficiency of tax expenditures.

Budget Control of Tax Expenditures

Given the importance of tax expenditures as a method of allocating resources in the economy in order to achieve public goals, there is naturally concern within the Administration and the Congress in exerting proper budget control over tax expenditures. At present, this control is exerted in several ways. Section 303 of the Budget Act prohibits the consideration of tax legislation effective for a fiscal year before the first budget resolution for that year has been adopted. Similarly, Section 311 of the Act prohibits tax legislation that conflicts with the revenue floor set by the second resolution. Section 308(a) requires that every bill or resolution that provides new or increased tax expenditures be accompanied by estimates for the current fiscal year and a five-year projection. In addition, Section 601 of the Act requires a list of tax expenditures to be included in the President's Budget, and similar lists are prepared annually by the Congressional Budget Office (under Section 308(c) of the Act), and by the staff of the Joint Committee on Taxation. These provisions provide some control, albeit indirect, over tax expenditures.

More importantly and directly, however, tax expenditures are consistently subject to review during consideration of major tax legislation. Most recently, as I have noted, there were substantial changes made in several tax expenditure items in the Economic Recovery Tax Act of 1981. In addition, changes in tax expenditure items are included in the Administration's current tax proposals.

A number of proposals have recently been made to require more formal Budget control procedures for tax expenditures, or to place explicit limitations on them. I believe these proposals are undesirable for several reasons. Changes in tax expenditure

provisions should be based on long-run considerations of economic efficiency and equity, rather than on short-run Budget considerations. Especially for those tax expenditures that concern long-term investments such as housing and business plant and equipment, decisions are made for several years at a time and a stable set of tax laws is therefore essential.

Furthermore, other policy instruments in addition to direct outlays, such as regulations and loan guarantee programs, are alternative ways to achieve the objectives of tax expenditures. Each of these instruments is intended to allocate resources in the economy in order to achieve public goals. A possible consequence of limiting tax expenditures, therefore, might be to increase off-budget spending which is not subject to the same restraints under the Budget Act as are direct outlays. In certain areas, tax expenditures might even be replaced by Government regulations in order to achieve the same or similar objectives.

It should also be noted that there is not universal agreement on the definition and measurement of tax expenditures. This lack of agreement is not critical to the current Budget procedures for controlling tax expenditures. With an explicit limitation or more formalized control procedures, however, both the concept _and_ the measurement of tax expenditures would have to be precisely defined. This would not be an easy task.

Even with precise definition and measurement of tax expenditures, however, severe difficulties would be encountered if an explicit limitation or more formalized control procedures were imposed on tax expenditures. One such difficulty is that the normal provisions of the income tax Code interact with tax expenditure provisions. For example, when individual income tax rates are lowered or increased, the value of most tax expenditures changes. How would these changes be handled? A second type of difficulty would arise with some of the limitations that have been proposed, for example, limiting tax expenditures to a fixed percentage of net revenues. Such a limitation could be exceeded during a short-run downturn in economic activity. It would therefore become necessary to reduce tax expenditures or to increase taxes, steps which could prolong and deepen the downturn. Another difficulty with measures that would focus attention on "special" tax provisions, however defined and measured, is that it would take attention away from all other tax provisions. Thus, there would be a real danger that provisions such as those that allowed tax straddles would persist in the tax Code.

The conclusion to be drawn from such considerations is not, of course, that tax expenditures should be free from review and control. Instead, I conclude that because tax expenditures arise from special tax provisions, they are best

reviewed and thereby controlled in the context of the entire tax Code, including the normal as well as the special tax provisions. This review takes place currently during consideration of tax legislation. No further Budget limitations or control procedures are required.

Summary

Tax expenditures are one method by which the Government allocates resources in the economy in order to achieve public goals. Many tax expenditures, such as the investment credit and those that encourage pension savings, serve important public goals in an efficient manner. Others, such as the business energy credits, are less desirable and should be repealed.

The concept of tax expenditures, properly defined, measured, and applied, is a useful tool for Budget analysis and control. The concept should not be confused with tax reform proposals, nor should estimates of tax expenditures be taken as equivalent to revenue gains from repeal.

The efficiency of tax expenditures relative to other methods of implementing programs depends on the required level of Government program administration, whether the tax expenditure is in the form of an exclusion or deduction rather than a credit, the specific group or activity the program will subsidize, the effect of other tax provisions on the tax expenditure, and the effect of the tax expenditure provision on income tax compliance costs and the perceived equity of the tax system.

While there has been some interest in imposing an explicit limitation or additional controls on tax expenditures, they would be difficult to implement and could seriously interfere with the desirable incentives provided by some tax expenditures.

I will be pleased to answer any questions you may have.

TREASURY NEWS

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STATEMENT OF
J. GREGORY BALLENTINE
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON TRADE OF THE
HOUSE WAYS AND MEANS COMMITTEE

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear before your Subcommittee in support of the Caribbean Basin Economic Recovery Act. As the President noted in his transmittal message, this Act is an integrated program designed to improve the lives of the peoples of the Caribbean Basin. The tax provisions of the Act are a vital element of this integrated program.

The tax incentives in this legislation may be divided into two parts: the investment tax credit designed to promote investment in Caribbean Basin countries and the investment tax credit and other tax incentives designed to restore the favored tax status of Puerto Rico and the U.S. Virgin Islands, the two U.S. possessions in the region, as well as the other U.S. possessions. I will first address the Caribbean Basin aspects of the legislation. Before discussing the specifics of the legislation, it will be useful to describe the economic characteristics of the region and the current levels of U.S. investment in the region. My discussion of the parts of the legislation pertaining to Puerto Rico and other U.S. possessions will also include a review of the relevant economic context of these proposals.

I. The Caribbean Basin

Economic Characteristics of the Caribbean Basin

The term "Caribbean Basin" as used in this discussion describes those Caribbean countries which are designated by the President as qualifying for the benefits of the Act. These may

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include Guyana, Suriname, and countries in Central America and the Caribbean islands. My remarks will be with reference to all the countries in the region with the exception of Cuba. Although by any reasonable standard all of the qualifying jurisdictions would be classified as developing countries, they are not a homogeneous group. They share certain features, such as low per capita income, high unemployment, lack of skilled labor, dependence on one or a few primary products, very little manufacturing activity, and small markets. But they vary widely in resources, institutions, and facilities for foreign investment.

A few countries have profitable mineral resources (oil in Trinidad and Tobago and bauxite in Jamaica, Suriname, and Guyana). Some have a reasonably sound agricultural base (the Dominican Republic and Guatemala). Some have developed trade or services sectors (Panama and Costa Rica). Some (the British Virgin Islands, the Cayman Islands, the Bahamas, and the Netherlands Antilles) are able to generate income from marketing tax savings to nonresidents. Others have practically no cash economy (Barbuda, St. Lucia, and St. Vincent). Although tourism is a major industry in the region, it cannot be relied on to support the economies of all the Caribbean countries. Some are not independent countries, but dependencies of the United Kingdom (e.g., the British Virgin Islands) or part of the Netherlands (Netherlands Antilles).

The languages spoken include Dutch, English, French, Spanish, and various dialects. The currency units differ. Communications and transportation facilities range from extremely poor to excellent. Political and economic stability vary, but are generally fragile. The total population of the area, 41 million, is governed by over 20 separate governments. The most populous country is Guatemala, with about 7 million inhabitants; the smallest are the Turks and Caicos Islands, with less than 10,000 persons. Per capita income varies from less than $300 per year in Haiti and St. Vincent to more than $3000 annually in the Bahamas and Trinidad and Tobago. A discouraging demographic factor is the high percentage of the population under 15 years old which is dependent for support upon a relatively unskilled work force.

U.S. Investment in the Caribbean Basin

At the end of 1980, U.S. direct investment (equity investment in foreign affiliates plus net outstanding loans to foreign affiliates) in the Caribbean Basin jurisdictions had a value of $10.2 billion, ignoring the Netherlands Antilles where a negative investment was recorded due to the borrowings of U.S. parent corporations through Netherlands Antilles affiliates. Of that amount, $5.9 billion, or 60 percent, was in the Bahamas and

Panama. Of the remaining $4.3 billion in investment, about $1.0 billion was in Trinidad and Tobago, $2.3 billion in Jamaica, the other Caribbean islands, Guyana, and Suriname, and the remaining $1.0 billion in Central American countries. A significant portion of the investment in Jamaica, Suriname, and Trinidad and Tobago is in mining (bauxite) or petroleum. U.S. direct investment in manufacturing in the region at the end of 1980 was about $1.0 billion, or approximately 10 percent of the total U.S. investment. Over 70 percent of the investment classified as manufacturing was in Panama and the Bahamas. Majority owned Caribbean basin affiliates of U.S. companies planned about $680 million in capital expenditures during 1980, of which $480 million was in mining and petroleum and $65 million in manufacturing.

II. Outlines of the Proposal

Requirements of an Effective Tax Incentive

To be effective, a U.S. tax incentive must cause more U.S. investment to take place in the Caribbean Basin than would otherwise occur. An incentive does this by raising the rate of return on investments, making some profitable which were previously unacceptable. An effective incentive should also attract projects which will continue to benefit the recipient economy after the expiration of the incentive period. The incentive should promote an increase in local production and employment in the Caribbean Basin, rather than simply encouraging transfers of financial or intangible assets. This can best be achieved by encouraging investment in real physical capital. An increased transfer of financial assets to the Caribbean Basin will contribute to economic growth in the Caribbean only if it increases the amount of physical investment or reduces its cost. This growth objective will be frustrated if the increased inflow of funds into the Caribbean is offset by an increased outflow of funds for investment outside the Caribbean.

Description of the Proposed Legislation

The Act includes an unprecedented extension for five years of the investment tax credit to property which is used predominantly in certain Caribbean Basin countries and which would otherwise qualify for the domestic investment tax credit. A Caribbean Basin country will qualify for this benefit if, first, it has been designated by the President as a country entitled to the benefits of the Act, and second, it enters into a bilateral executive agreement with the United States for exchange of information for tax administration purposes.

The rules and limitations which apply to the allowance of the investment tax credit for property used predominantly in the United States will generally apply to Caribbean Basin property. The regular investment credit is generally available for up to ten percent (10%) of the cost of tangible personal property and other tangible property (generally not including buildings or structural components) used in connection with manufacturing, production, agriculture or certain other activities. A few narrow categories of property, such as qualified rehabilitated buildings and qualified timber property, will not be eligible for the credit if located in a Caribbean Basin country because of the specific statutory provisions governing their eligibility for the credit. In our judgment, it is not advisable to extend the credit for these specialized categories of property.

The sunset provision reiterates that this is a special measure intended to provide economic assistance in an extraordinary situation. At the end of five years consideration may be given to an extension of the credit on a bilateral basis through a tax treaty.

Relative Advantages of the Investment Tax Credit

A wage subsidy and tax sparing, along with the investment tax credit, were considered as possible incentives for the Caribbean Basin. Since the Caribbean Basin needs to develop the skills of its indigenous labor force, a labor oriented subsidy has considerable intuitive appeal. This type of incentive, however, does not increase the capital-labor ratio and therefore it does not improve the long run productivity of the labor force. It is a temporary incentive that ceases to have effect as soon as wages are no longer subsidized. A country merely tends to become dependent on the wage subsidy, with little prospect for the type of growth and development that will lead toward economic self-sufficiency. The recipient countries themselves may resent a wage subsidy. They may view it as a "colonialistic" attempt by the United States to restrict the Caribbean Basin to the role of a supplier of low wage goods. For these reasons, it is preferable to rely on a capital incentive which indirectly encourages the employment of more labor and which will improve the overall productivity of labor.

Tax sparing is often proposed as an investment incentive for regions like the Caribbean. Tax sparing allows a credit against domestic taxes for taxes an investor is spared from paying when a foreign country reduces or waives tax liabilities as an investment incentive. There are two major economic objections to tax sparing as an investment incentive. The first is that tax sparing is a reward to profits earned during the incentive period, regardless of whether such profits come from prior or new

investments. That is, no new investment is needed to obtain the benefits. Thus, there is no assurance that tax sparing will contribute to economic growth by increasing real physical capital investment in the recipient country. Secondly, tax sparing invites non-productive investments, such as the transfer of financial or other intangible assets and the assignment of artificially high profits to such assets, in order to generate tax spared income.

In contrast, the investment tax credit which we are proposing will encourage the placement of machinery and equipment in the Caribbean Basin. The credit depends directly on an investor making a productive investment in the Caribbean Basin. By providing workers with additional capital, it will increase labor productivity and economic growth and development in the region.

Finally, the investment tax credit is independent of the foreign tax credit, requires no revenue sacrifice by the developing countries, and is relatively simple. Potential U.S. investors in the Caribbean Basin region are familiar with the credit as it applies to domestic investments. Its effectiveness will not be undercut by the uncertainty which would accompany any totally new incentive.

III. Details of the Proposal

Qualifying Caribbean Basin Countries

A Caribbean Basin country which is designated by the President as eligible for the benefits of the Act will qualify for the extension of the credit only if the country enters into a bilateral executive agreement with the United States to exchange such information as is necessary and appropriate to carry out and enforce the tax laws of the two countries.

Exchange of tax information assists the administration of the tax laws of both the United States and the qualifying country. The tax administrators of the Caribbean Basin countries will have access to information from the IRS regarding their taxpayers who engage in economic activities in the United States and thereby should strengthen their own tax administration. This self-help aspect of the measure is consistent with the overall concept of the Caribbean Basin Initiative. Moreover, the United States will itself require access to such information to adequately administer the tax credit, particularly where a "pass-through" credit is claimed by a five percent (5%) or greater U.S. shareholder in a foreign corporation. (The "pass-through" aspect of the proposal is discussed below.)

In addition, several countries in the Caribbean Basin region are tax havens which have been used both for avoidance and evasion of U.S. tax laws. We do not believe that it is appropriate for countries to benefit from U.S. tax incentives unless they are willing to cooperate with the United States in matters of tax administration.

Exchange of Information Agreements

The legislation authorizes the Secretary of the Treasury to negotiate and conclude the exchange of information agreements. While the Secretary is accorded discretion regarding what kinds of information will be included within the scope of the exchange of information provisions, the Act imposes certain minimum standards for such agreements.

The exchange of information provisions in the agreements must include within their scope tax information pertaining to "third-country persons," that is, nationals or residents of countries other than the United States or the Caribbean Basin country that is a party to the agreement. This approach is consistent with our present tax treaty policy, embodied in Article 26 of the U.S. Model Income Tax Treaty. In accordance with that policy, a jurisdiction with restrictions on disclosure of information regarding such third country persons would be required to modify such restrictions. The same principle applies with respect to disclosure of information regarding ownership of bank accounts or share ownership. Most countries do not place restrictions on disclosure of such information; such limitations are characteristic primarily of jurisdictions which have organized themselves as tax havens.

The exchange of information agreements will be terminable on reasonable notice by either party. This will permit the credit to be terminated with respect to future investment in the event that the President revokes his designation of the country as a country eligible for the benefits of the Act.

The Secretary may incorporate by reference in an exchange of information agreement the exchange of information provisions of an existing income tax treaty with a Caribbean Basin country, provided such treaty provisions otherwise satisfy the requirements of the statute. Our more recent tax treaties, such as the recently ratified treaty with Jamaica, will satisfy such standards and we would be desirous of extending this tax incentive to these treaty partners as expeditiously as possible. It should be clearly understood that exchange of information agreements may be entered into with a country whether or not the country has a tax treaty with the United States.

It is expected that the exchange of information agreements will generally become effective on signature. The text of the agreements will, of course, be transmitted to Congress not later than sixty days after the agreement has been signed, in accordance with the prescriptions of the Case Act (1 U.S.C. section 112b).

Predominant Use

Property used predominantly outside the United States generally is not eligible for the investment tax credit. The Act establishes an additional exception to this rule for Caribbean Basin property; that is, property used predominantly in one or more qualifying Caribbean Basin countries is made eligible for the credit.

Under existing Treasury regulations the test for determining predominant use is the physical location test. Thus, if property or equipment is located in one or more qualifying Caribbean Basin countries during more than 50 percent of the taxable year, the predominant use test will be satisfied. The same regulations also provide that the determination of whether a credit is allowable with respect to any property is made only with respect to the year the property is placed in service. If property is thereafter used predominantly outside the United States the credit taken with respect to such property will be subject to recapture. A credit taken with respect to qualifying Caribbean Basin property will be subject to recapture if the property is used predominantly outside one or more qualifying Caribbean Basin countries and the United States.

The Act provides an exception to this recapture rule in the case where a qualifying Caribbean Basin country no longer constitutes a qualifying country because the President's designation of the country as eligible for the benefits of the Act is terminated or the exchange of information agreement is terminated. In such a circumstance, property which continues to be used predominantly in the country in succeeding taxable years without interruption will not be subject to the recapture rules. It would not be equitable to subject the credit for such property to recapture because of an event which is not within the taxpayer's control.

Pass-through of Credit to Five Percent U.S. Shareholder of Foreign Corporation

To summarize my discussion to this point, the credit will be allowed to a U.S. citizen, resident, or corporation that invests in property that is used predominantly in one or more qualifying Caribbean Basin countries after the enactment of the Act. Under present law, however, the credit would not be available to a U.S.

shareholder that makes an equity investment in a foreign corporation that invests in qualifying property. Where, for reasons of local law or accepted business practice, it is necessary that the business activity be carried on through a "host country" corporation, allowance of the credit solely with respect to property owned directly by a U.S. person would not constitute an effective investment incentive.

To surmount this problem and ensure the effectiveness of the credit as an investment incentive, we have designed a pass-through mechanism which would allow the credit on a current basis to a U.S. shareholder that owns five percent or more in value of a foreign corporation's stock, subject to certain limitations.

The pass-through credit is computed with respect to the shareholder's pro rata share of the foreign corporation's investment in Caribbean Basin property. The shareholder's pro rata share of such investment is limited for this purpose, however, to the amount of the shareholder's actual additional equity investment in the corporation after the date of enactment of the Act. The purpose of this limitation is to key the incentive in these circumstances to new equity investment which is permanent in nature and subordinate to debt claims or trade payables. In our view, new equity investment is the kind of investment which is likely to be responsive to the credit and which will form the base for continued future growth in the Caribbean Basin economies.

The limitations on the pass-through credit also take into account the concern that the credit is allowed currently while income earned by a foreign corporation is generally not subject to U.S. taxation until it is repatriated as a dividend to the U.S. shareholder. It is for this reason that the pass-through credit is not allowed with respect to investment of retained earnings of the foreign corporation in Caribbean Basin property. The foreign corporation's investment must be attributable, directly or indirectly, to new equity investment by the U.S. shareholder. This protects against the possibility of an initial profitable investment generating a continuous series of credits for a shareholder while U.S. tax on the income generated by such investment is deferred.

Summary View of Investment Tax Credit

The five year extension of the credit I have described is an innovative, carefully targeted incentive for new physical investment in Caribbean Basin countries. This proposal represents as powerful a tax incentive for investment as is feasible without disturbing the integrity of our tax system. Its revenue cost will be about $50 million in 1983.

Relation of Extension of Credit to U.S. Tax Treaties

The United States has a number of tax treaties with countries in the Caribbean Basin region, including extensions of certain of our older treaties with the United Kingdom and the Netherlands. It is our longstanding tax treaty policy to provide U.S. source basis tax benefits to the residents of the treaty partner and to obtain tax benefits for U.S. residents. We do not, as a general rule, limit our residence basis taxation of our citizens and residents. The decision to provide a tax credit incentive for investment in qualifying Caribbean Basin countries is generally at variance with our treaty policy of not limiting (or reducing) U.S. taxation of our citizens and residents. This decision highlights the special nature of our relationship to the Caribbean Basin region and the importance we attach to this Initiative.

Countries outside the Caribbean Basin region will, no doubt, seek similar benefits through tax treaties. The United States has exchanged notes with a number of developing country tax treaty partners in which we acknowledge the partner's desire to include investment incentives in the treaty, but state that the United States is not in a position to agree to such incentives. The letters go on to state that if policies change in this regard in the future, the United States will reopen discussions with a view to amending the treaty to include an investment incentive. These countries may view the extension of the tax credit as such a change in our policy. A decision regarding further extensions of the investment tax credit, both to existing and new treaty partners, would not be made without full consultation with interested Congressional committees.

The extension of the investment tax credit for Caribbean Basin property is not inconsistent with this Administration's strong policy against use of our tax treaties for conduit investments in the United States by residents from countries other than our treaty partner. Our opposition to such tax treaty abuse is sound international tax policy and consistent with the objectives of our Caribbean Basin Initiative. The purpose of the Initiative is served by encouraging increases in productive economic activity and self-sustaining growth in the Caribbean Basin countries. This purpose is not served by creating or sustaining tax haven activity which is contrary to U.S. tax treaty policy, undermines the operation and administration of the Internal Revenue Code, and fosters an increased dependence by the tax haven country on the United States.

IV. Puerto Rico and Other U.S. Possessions

As an essential counterpart to the proposals to assist Caribbean Basin countries, the Act includes important tax incentive and revenue measures for Puerto Rico and the U.S. Virgin Islands. Some of these measures will also benefit other U.S. possessions.

Background of the Legislative Measures Affecting the Possessions

Puerto Rico and the U.S. Virgin Islands have a special and historic relationship with the United States which this Administration recognizes and values. U.S. tax policy has long extended favored tax treatment to investment in Puerto Rico, the U.S. Virgin Islands and other U.S. possessions. The passage of the Economic Recovery Act of 1981 (ERTA), however, substantially, but unintentionally, reduced the effectiveness of these incentives. Further, making the investment tax credit available to investment in qualifying Caribbean Basin countries will encourage investment in the Caribbean Basin, possibly to the detriment of Puerto Rico and the U.S. Virgin Islands. It is essential that Puerto Rico and the U.S. Virgin Islands share in the expected economic progress, growth, and stability in this region. Special investment incentives must be provided for these possessions so that the development in the Caribbean Basin induced by the Initiative does not occur at the expense of Puerto Rico or the Virgin Islands.

The importance of the measures contained in this legislation is underscored by the adverse economic situation facing Puerto Rico. The Puerto Rican unemployment rate is approximately 22 percent, with no immediate prospect of decreasing. Investment in plant and equipment in 1980, after adjusting for inflation, was only one-half the value of investment in 1970. Between 1980 and 1981, the number of contractual agreements between the Puerto Rican Economic Development Administration and potential non-local investors dropped sharply. This drop in new contractual agreements indicates that the number of manufacturing plants beginning operation in Puerto Rico in the immediate future is likely to fall.

To adjust for the impact of ERTA and the Caribbean Basin Initiative, the Administration is proposing to extend certain tax incentives for investment to the U.S. possessions and to modify the rum excise tax payment arrangements with Puerto Rico and the U.S. Virgin Islands. Although the tax incentives will be available to the U.S. Virgin Islands and all other possessions, their principal impact will be with regard to business operations in Puerto Rico.

Existing U.S. Tax Policy Toward Puerto Rico

The encouragement of manufacturing investment in Puerto Rico is a longstanding tenet of Federal tax policy. This principle is rooted in the belief that increased capital investment is the most effective way of encouraging real economic growth in Puerto Rico. Generally speaking, the Federal tax laws have encouraged

Puerto Rican investment by exempting income from such investment from U.S. taxation. Puerto Rico has, in turn, granted tax holidays for most manufacturing operations. Thus, U.S. manufacturing corporations operating in Puerto Rico generally pay little or no U.S. or Puerto Rican tax.

Under section 936 of the Code, a U.S. corporation (the 936 corporation) deriving income from Puerto Rico is subject to Federal tax on its worldwide income, but a special credit available under section 936 fully offsets the Federal tax on income from a trade or business in Puerto Rico or from "qualified possessions source investment income." A U.S. corporation which owns at least 80 percent of a section 936 corporation is also exempt from Federal tax on the dividend income from the 936 corporation. Since 1948, Puerto Rico has had a complementary program of tax exemption, called Operation Bootstrap, under which exemptions from Puerto Rican tax have been offered as incentives to U.S. companies to invest in manufacturing plants in Puerto Rico.

Prior to the passage of the Economic Recovery Tax Act of 1981, section 936 provided a significant incentive to invest in Puerto Rico compared to the United States. By reducing the effective corporate tax burden on U.S. investment through the Accelerated Cost Recovery System (ACRS) and liberalizing the investment tax credit, ERTA erodes the relative value of the Puerto Rican tax incentive. Once the provisions of ERTA are fully effective, a substantial amount of U.S. investment will be taxed nearly as favorably as Puerto Rican investments, thus eliminating any tax incentive for investing in Puerto Rico. The Administration proposes to restore the incentive to invest in Puerto Rico by extending the benefits of ACRS and the investment tax credit to U.S. corporations operating in Puerto Rico and the other possessions. Restoration of the incentive will require that the full investment tax credit plus one-half of the ACRS deductions be made available to a U.S. corporation owning a section 936 corporation.

Description of Tax Incentives

Under present law, property used predominantly outside the United States generally is not eligible for the investment tax credit. However, property owned by a domestic corporation and used predominantly in a U.S. possession qualifies for the credit unless the domestic corporation has in effect an election to claim a Puerto Rico or possession tax credit under section 936 (a section 936 corporation) or is entitled to the benefits of section 934(b), relating to reduction in tax liability incurred to the Virgin Islands (a section 934(b) corporation). Also, property owned by a U.S. citizen and used predominantly in a U.S.

possession qualifies for the credit unless the U.S. citizen is entitled to the benefits of Code sections which limit U.S. taxation of income derived in a U.S. possession. The Caribbean Basin Economic Recovery Act would allow the investment tax credit for any property owned by a section 936 or 934(b) corporation or by a U.S. citizen entitled to the benefits of such Code sections and which is used predominantly in a possession of the United States. The Act also provides that property used in a possession would be eligible for the recovery lives generally available for property not used predominantly outside the U.S. Thus, it will extend ACRS to property used in a possession.

Because section 936 and 934(b) corporations would be unable to use these tax benefits, the Act provides for a pass-through of the investment tax credit and fifty percent of the cost recovery deductions attributable to property owned by a section 936 or a domestic section 934(b) corporation to certain U.S. corporations that together own 80 percent or more of the stock of the section 936 or 934(b) corporations. Thus, a U.S. corporation that would be a member of an affiliated group that includes the section 936 or domestic 934(b) corporation (but for special rules excluding section 936 and 934(b) corporations from an affiliated group), would be allowed the investment tax credit and fifty percent of the cost recovery deductions otherwise allowable to the section 936 or domestic 934(b) corporation.

Effect of Proposal

These investment incentive provisions will reduce the cost of capital and promote real economic growth in Puerto Rico, the U.S. Virgin Islands, and other U.S. possessions. This proposal will restore the relative preference for investment in Puerto Rico that existed prior to the passage of ERTA. It reaffirms the Congressional policy of encouraging investment in Puerto Rico and provides a significant incentive to invest in the plant and equipment which is vital to economic growth of the possessions. Its revenue cost will be about $55 million in 1983, rising to $100 million annually by 1985.

Disposition of Excise Taxes on Rum

Under present law, the Internal Revenue Code imposes an excise tax on rum. All taxes collected under the Internal Revenue Code on rum produced in Puerto Rico or the U.S. Virgin Islands and transported to the United States (less the estimated amount necessary for payment of refund and drawbacks), are paid to Puerto Rico or the U.S. Virgin Islands, respectively.

At present, Puerto Rico and the U.S. Virgin Islands supply about 90 percent of the U.S. rum market. Rum produced in Puerto Rico and the U.S. Virgin Islands enters the United States duty

free. The reduction in import duties on rum produced in other Caribbean Basin countries, provided for in the trade title of the Act, will reduce the Puerto Rican and U.S. Virgin Islands' share of the U.S. rum market. This will adversely affect the rum industry in Puerto Rico and the U.S. Virgin Islands and reduce the amount of U.S. excise tax collections which they receive.

In order to maintain this revenue source for the islands, the legislation provides that all excise taxes collected at the current tax rates on rum imported into the United States from any country (less the estimated amount necessary for payment of refunds and drawbacks) will be paid over to the treasuries of Puerto Rico and the U.S. Virgin Islands. The amount per proof gallon paid over will not exceed the amount per proof gallon which would have been paid over if the rum had been produced in Puerto Rico or the U.S. Virgin Islands. The Secretary of the Treasury will prescribe by regulations a formula for the division of these tax collections between Puerto Rico and the U.S. Virgin Islands. The estimated revenue cost of this provision is about $18 million in 1983.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE
March 16, 1982

CONTACT: GEORGE G. ROSS
(202) 566-2041

U.S. AND SWEDEN TO CONDUCT INCOME TAX TREATY NEGOTIATIONS

The Treasury Department today announced that representatives of the United States and Sweden will meet in Washington during the week of March 22, 1982 to renegotiate the income tax treaty between the two countries which has been in effect since 1939.

Since the treaty has been in effect for so many years, the negotiations will encompass a complete review of all of its provisions. The discussions will take into account changes in the tax laws of both countries and developments in the model income tax treaties published by the Organization for Economic Cooperation and Development (OECD) and by the United States.

Anyone wishing to provide information or comments on tax matters related to the forthcoming negotiations is invited to do so by writing to A. W. Granwell, International Tax Counsel, U.S. Treasury Department, Room 3064, Washington, D.C. 20220.

This notice will appear in the Federal Register on March 18, 1982.

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TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE

March 17, 1982

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $5,254 million of $10,507 million of tenders received from the public for the 2-year notes, Series Q-1984, auctioned today. The notes will be issued March 31, 1982, and mature March 31, 1984.

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	14.08% 1/	100.076
Highest yield	14.16%	99.941
Average yield	14.14%	99.975

Tenders at the high yield were allotted 48%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 97,510	$ 69,495
New York	8,075,120	3,938,735
Philadelphia	85,600	67,000
Cleveland	201,185	175,435
Richmond	114,940	93,340
Atlanta	108,650	91,620
Chicago	1,048,335	281,395
St. Louis	128,000	115,735
Minneapolis	59,155	54,655
Kansas City	91,795	91,295
Dallas	61,220	53,620
San Francisco	426,740	212,580
Treasury	8,615	8,615
Totals	$ 10,506,865	$5,253,520

The $ 5,254 million of accepted tenders includes $1,327 million of noncompetitive tenders and $3,592 million of competitive tenders from private investors. It also includes $335 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 $ 5,254 million of tenders accepted in the auction process, $600 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 $225 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

1/ Excepting 1 tender of $25,000.

TREASURY NEWS

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

For Release Upon Delivery
Expected at 3:00 p.m.

Address
by
The Honorable Beryl W. Sprinkel
before the
Conference on Supply Side Economics
Atlanta, Georgia

March 18, 1982

Good Afternoon.

It is good to be down here in Atlanta with you. I think it is fair to say that this city has definitely become the hub of the south. In fact people joke that when they die - on their way to heaven (or wherever) they will have to change planes in Atlanta!

Judging from the program here, it appears that in order to be a certified supply sider you also need to change planes - and stay awhile - in Atlanta.

I know that Dave Meiselman spoke to you yesterday about the relationship between supply side and monetarist economics. So I am not going to dwell on it. But I would like to kick in my two cents on the subject because there is such a pervasive misunderstanding on this point.

How many times do you read in the newspapers these days that the Administration's fiscal policy and the Fed's tight money policy are running head long into each other?

And how many times do you read that the supply side and the monetarist side of the Administration's policies are fighting with each other?

In spite of the frequency of their appearance in the media, both of these statements are untrue. Not only are supply side and monetarist policies compatible, it is essential that they go together.

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There are three great challenges to economic policy. The first challange is coming up with the right policy in the first place. The second is implementing it. And the third is communicating that policy in such a way that the public understands it.

For those who still think there is some kind of conflict with the supply side and monetarist economics, perhaps it is useful to think of the situation this way.

The heart and soul of any economy are the freedom, opportunity, and incentives which it provides to individual initiative. Monetary and supply side economics are based on the proposition that private initiative is the source of wealth and higher standards of living. Both theories argue that government policies can be a significant detriment to private initiative and both seek to reduce this perverse government influence.

What has been characterized as the supply side of our economic policy deals with the effect government spending and financing has on the willingness and ability of individuals to take a chance on productive ventures. The monetarist component deals with money in the belief that high and variable inflation is detrimental to work, savings and investment. And that inflation is a monetary phenomenon. The goal of the supply side and monetary elements of our policy is the same: to increase the productive potential of the economy. The only difference is that they focus on different aspects of government behavior.

Reaganomics is carefully designed to rid us of stagflation by limiting money growth and inflation, while increasing incentives to produce more real goods and services.

Let me now turn to the subject that I was asked to speak on: Reaganomics: The Monetary Component.

First, the monetary component of the President's overall economic policy must be seen in the light of our single over riding objective. And that objective is to obtain real and sustained non-inflationary economic growth in this country. That is what we are all about on the economic front.

We want inflation to keep coming down and to stay down. We want interest rates to keep coming down. We want to balance the budget. And we want to reduce Federal spending as a percent of GNP. But all of these objectives - while very important in their own right - are keyed in to the over riding goal of achieving strong, sustained economic growth in America.

Now, what role does money and monetary policy play in achieving that objective? In order to answer that question, we must be clear on what money is and, perhaps more importantly, what it is not. Money is a construct, whose sole purpose is to facilitate trade and to improve the efficiency of markets. It exists to provide a consistent measure of the relative value of real resources, both currently and over time. In sum, it is the medium of exchange. Money is not the ball game; it is only the ticket into the stadium.

It is our view that the maximum efficiency of our monetary system requires a simple, straightforward policy: moderate, steady growth in the money supply.

Earlier this year, the Fed announced money growth targets for 1982. They are, in our view, appropriate target ranges and the Administration's endorsement of them is total.

There are, however, lingering doubts in the financial markets that this policy will be maintained. There are a variety of reasons for these fears, and this condition is one of the major obstacles in the transition from a high-inflation/low-growth economy to one of low-inflation/high growth.

Imagine for a moment, that investors, bankers - the public at large - was very confident that money growth was going to be sure and steady and gradual. Whether there was an election, whether there was a recession; whether there was a budget deficit; whatever. It was going to stay the same.

Would that -- that is, the belief itself -- make any difference in terms of our goal of increased real growth? I submit that it would. Because savings, investment and capital expansion decisions would be made in an environment where "the element of the unknown" was significantly reduced. Other countries, such as Japan and Germany, have that type of environment and they have enjoyed enviable rates of inflation and interest as well as economic growth. They have established that environment because they have a sound, credible monetary policy.

Let's look at it this way: The whole point of monetary policy is to establish and maintain an environment where the positive effects of supply side actions can be maximized. A sound monetary policy simply sets up the nominal side of the equation so that supply side economics can really go to work on the real output side. And that is why it is essential that supply side economics go hand in hand with a stable monetary policy. One cannot work without the other.

Interest rates consists of three parts: the real rate, the inflation premium and an uncertainty premium. Deficits, if they are very large, do tend to put upward pressure on the real rate which has historically been around 3-4 percent. This effect, however, is slight. Of more consequence is the inflation premium. If a lender thinks the rate of inflation will be lower in the future, he can reduce his overall rates and still expect to make a buck. Today, slow, steady money growth and declining inflation are putting strong downward pressure on the other two components.

Now, how do we achieve this stable money policy?

The burst of financial innovation in recent years has reinforced the idea that monetary policy has been (or is being) rendered ineffective as a tool for economic stabilization. However, the evidence that is provided to support this conclusion is largely anecdotal. People look at the rapid growth of new types of transfer accounts and money market mutual funds, and conclude that they <u>must</u> have a fundamental impact on monetary relationships.

The implication of all these anecdotes is that the nature of "money" in our economy is changing so rapidly that either (1) the Federal Reserve can no longer define money, let alone control it adequately, or (2) controlling money, if possible, is no longer a useful policy.

While all these changes are undeniably going on and are important, they do not lead either to the conclusion that the Federal Reserve's ability to conduct monetary policy is being hampered, or to the conclusion that the economic impact of monetary policy has been weakened. Effective monetary policy actions require only that there exist some economic variable -- be it the money supply, the monetary base, or the price of carrots -- that meets two conditions:

First, it must be controllable -- and ideally with some precision -- by the Federal Reserve. This condition eliminates a lot of potential candidates, including the price of carrots.

Second, it needs to be an economic variable that is related in a reliable way to the economy.

Consider the first condition. Relative to the thousands of pieces of economic data that we regularly collect in this country, there are but a handful of economic variables that the Federal Reserve can control to some degree. That small group includes, of course, several measures of the money supply, the monetary base, and several measures of bank reserves. I should

add that some would also include interest rates or bank credit as candidates, but in my view the Federal Reserve cannot effectively control either with an acceptable level of precision over the long run. Certainly the Federal Reserve cannot control total credit.

In my opinion, the monetary base is a useful and reliable measure of the monetary actions of the Federal Reserve. The base is simply the sum of certain items on the Federal Reserve's balance sheet and since it can exactly control the largest asset (its portfolio of government securities) the monetary base can be closely controlled even in the short run. This is less true of the money stock -- and the precision of control declines as we move from M1 out to the broader money measures, M2 or M3.

It is certainly true that financial innovations can change the assets that constitute transaction balances in our economy. At times, these changes have necessitated changes in the definitions of money, such as in 1981 with the introduction of nationwide NOW accounts. But with the information, and technical expertise available to the Federal Reserve, such adjustments can be, and have been, made. The particular menu of items which is included in the measure of "money" is not the most important issue. Instead, the major concern is to define a monetary aggregate that the Federal Reserve can control.

Financial innovation has no effect on controlling the monetary base. Despite the large growth of NOW accounts in 1981, the ability of the Federal Reserve to control the average growth of M1 was apparently unimpaired.

The relationship between the monetary base and M1 has remained extremely stable over the past decade, despite the much talked about increased pace of financial innovation. If one looks at the trends over the past decade, one will find that the link between the base and the money supply did not become less predictable as the pace of financial innovation has quickened. If financial changes were interfering with the Fed's ability to control M1 we would observe increased variation between changes in the base, which the Fed can control exactly, and money growth. The stability of the money multiplier shows that this is simply not the case.

Now, to my second condition: that once we control money, it must be predictably and reliably related to the economic variables we really want to influence. If financial innovation has reduced the effectiveness of monetary policy, we would expect to see greater variability in the relationship between money and GNP; that is, velocity.

While velocity does vary substantially from one quarter to the next, it has shown remarkably little variation over periods of several quarters and has had a constant trend growth of 3.1 percent per year since 1959. There is no sign that this relationship has been upset in recent years by financial innovation.

One clear effect of recent financial innovation has been a wide divergence among the rates of growth of various measures of money. This is nothing new. Since M2 contains a number of interest-sensitive components, variations in interest rates have always caused the growth of M2 to diverge from that of M1. Before the introduction of money market certificates and other items that pay a market-related rate of interest, M2 growth would slow when interest rates rose as funds were drawn out of savings accounts and into market instruments. Now, with the relaxation of interest rate ceilings and the inclusion in M2 of instruments that pay a market return, M2 grows more rapidly than M1 as interest rates rise.

This was the case during 1981, when M2 grew much more rapidly than M1B. However, this does not mean that the efficacy of monetary policy has been diminished because when M2 growth diverges from M1, GNP (which is what we want to influence) has not followed the path of M2, but instead has continued to follow M1 growth, (defined to include NOW accounts). That is, the reliable and predictable relationship between M1 growth and GNP growth is not changed by divergent growth in M2. The 1981 experience only reaffirms this.

Differing rates of growth in M1 and M2 typically lead to questions and concerns about which monetary aggregate is the better guide to monetary actions. Returning to the two conditions I listed earlier, the money aggregate that is most controllable by the Federal Reserve and most reliably related to economic activity is, by either criterion, M1.

At the present time, I see no need for changes in regulations or in the Federal Reserve's powers to compensate for the effects of financial innovation.

Arguments for changes in regulation might also be based on issues of equity between types of financial institutions and organizations. Whatever the motive -- whether out of perceived concern about monetary control or about equity -- action to stop or reduce the effects of financial innovation usually involve some addition to, or extension of, government regulation. It is important to recognize that much of the financial innovation we have witnessed in recent years has been <u>in response to</u> regulation. Money Market Mutual Funds are probably the most successful example of such innovation. If we have slow, steady money growth, this will favorably affect investment decisions and contribute to lower rates of interest.

There is a rather subtle shift taking place in America. 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, which is now, 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. Volatility in policy delays desired movement into stocks and bonds.

Conclusion

Let me sum up then, in a very brief fashion, what we have here.

First, the monetary component of Reaganomics is critical to the overall program. The old garden-and-soil analogy is applicable here. The supply side promise of real growth and prosperity is sound. The incentive effects will work in America in the 1980's just as they have worked hundreds of times before in our own country and in other countries.

But they will not work unless there is a fertile, stable monetary environment. You can have the best seeds in the world, but they will not grow without the proper soil.

Secondly, the Fed can control the money supply and therefore the "monetary environment" for the economy. If you look at the data you will see the following relationships:

Inflation, nominal GNP and interest rates follow M1 growth. M1 growth, in turn, follows the growth of the monetary base. And the Federal Reserve could, if it chose, control the base -- to the penny. To those who are skeptical of this approach, I say "Try it, you'll like it."

Let me conclude by saying that history will record this Administration as a low inflation -- low interest rate -- high growth Administration. But please remember, we inherited a pretty tough situation.

You know, when Don Regan and I first went to Washington, we felt like 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!"

We were tempted to leave, but we stayed, and we are staying. And in the last twelve months we have had to spend a great deal of time repairing the wreckage from the last Administration. But we are now on a sure, steady course toward low inflation, lower interest rates and real economic growth in America. For us fully to realize our potential, we must have less volatility in monetary growth.

Thank you.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
March 18, 1982

Contact: Stephen Hayes
566-2041

Unblocking of Czechoslovak Assets

The Department of the Treasury announced today the unblocking of Czechoslovak assets located in the United States. This action was taken in accordance with the Settlement of Certain Outstanding Claims and Financial Issues, which was signed by the United States and the Czechoslovak Socialist Republic on January 29, 1982.

Czechoslovak assets were previously blocked under the Foreign Funds Control Regulation, 31 C.F.R. Part 520. The initial blocking, which occurred in 1941, was intended to prevent nationals of Czechoslovakia from being forced under duress to transfer to the Axis powers their claims to assets in the United States.

The blocking also served as a weapon of economic warfare to hamper the financial and commercial activities of the World War II enemies of the United States. After the end of World War II, the United States continued to block Czechoslovak assets as a response to the nationalization by the Czechoslovak Government without compensation of property of certain United States nationals.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE March 18, 1982

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $ 5,251 million of 52-week bills to be issued March 25, 1982, and to mature March 24, 1983, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: (Excepting 2 tenders totaling $3,195,000)

	Price	Discount Rate	Investment Rate (Equivalent Coupon-issue Yield) 1/
High -	87.391	12.470%	13.98%
Low -	87.328	12.533%	14.06%
Average -	87.352	12.509%	14.03%

Tenders at the low price were allotted 38%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 40,715	$ 21,715
New York	7,363,490	4,277,750
Philadelphia	31,845	31,845
Cleveland	95,920	71,920
Richmond	99,090	60,470
Atlanta	45,270	44,770
Chicago	702,635	152,635
St. Louis	56,385	35,045
Minneapolis	14,415	10,415
Kansas City	28,195	27,695
Dallas	15,515	15,515
San Francisco	795,850	437,750
Treasury	63,050	63,050
TOTALS	$9,352,375	$5,250,575
Type		
Competitive	$7,422,390	$3,320,590
Noncompetitive	428,185	428,185
Subtotal, Public	$7,850,575	$3,748,775
Federal Reserve	1,000,000	1,000,000
Foreign Official Institutions	501,800	501,800
TOTALS	$9,352,375	$5,250,575

An additional $ 3,300 thousand of the bills will be issued to foreign official institutions for new cash.

1/ The average annual investment yield is 14.52%. This requires an annual investment yield on All-Savers Certificates of 10.16%.

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MAR 25 '82

TREASURY DEPARTMENT

<u>For Release Upon Delivery</u>
Expected at 10:00 a.m.
March 22, 1982

STATEMENT OF
THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
OF THE INTERNAL REVENUE SERVICE
COMMITTEE ON FINANCE

Mr. Chairman and Members of this Committee:

I am pleased to be here today to discuss the provisions of S. 2198, the "Taxpayer Compliance Improvement Act of 1982." In general, we view this bill as an important step in reducing the compliance tax gap -- which Commissioner Egger has just described.

<u>Overview</u>

This is a particularly appropriate time to consider steps that might be taken to collect taxes due under existing law which, for a variety of reasons, currently escape collection. I would like to compliment the Chairman and this Committee for holding hearings on the issues presented by the tax gap. I would also like to thank the Chairman and other sponsors of S. 2198 for introducing this measure, which we think takes important steps toward reducing the compliance tax gap as well as preserving the integrity of our voluntary tax compliance system.

The provisions of S. 2198 may be divided into five categories: (1) broadening the scope of and improving the quality of information reporting; (2) reworking the penalty structure of the Internal Revenue Code to correct certain deficiencies, and to deter troublesome and growing abuses

that may reflect increasing public acceptance of noncompliance; (3) adjusting the method of computing interest on payments and receipts by the IRS; (4) revising the antiquated rules dealing with voluntary withholding of tax on retirement plan distributions; and (5) ancillary issues, chiefly application of the Paperwork Reduction Act of 1980 to Treasury and IRS. I will discuss each of these provisions in turn.

Reporting Requirements

General

Under existing law, many types of payments are subject to information reporting. Most payments of dividends and interest aggregating more than $10 in a year are required to be reported to the IRS on Form 1099. Copies of Form 1099 are also required to be sent to taxpayers so that they will have the amount of income from each source readily available. The chief class of obligations that is not covered by these reporting rules is obligations of the United States Government (although there is reporting by the Bureau of the Public Debt to IRS on some types of obligations). Payments such as royalties, rents and annuities are subject to information reporting if the payor is engaged in a trade or business, and the payments in a year exceed $600.

Wages paid to individuals are subject to information reporting in addition to withholding of tax at source. The wage withholding system has been in place for almost forty years; the system has long been accepted, and it is generally agreed that the system functions well.

S. 2198 would effect major changes to the tax rules governing information reporting. The thrust of these provisions is to increase the number of transactions subject to information reporting and, in conjunction with certain proposed penalty provisions, to improve the quality and usability of reported information. We recognize that information reporting on taxable transactions is valuable both to the Government -- to enable it to check the information reported by taxpayers -- and to the vast majority of taxpayers who conscientiously attempt to report all of their income. Time and experience have shown, however, that information reporting is not a panacea: We need only contrast the rate of taxpayer compliance in the wage area, where withholding is generally required, with current levels of compliance in areas where only information reporting is

required. It is estimated that wage and salary income, most of which is subject to withholding, is underreported by only 2 or 3 percent; on the other hand, the comparable figure for interest and dividend income, most of which is subject to information reporting only, is between 10 and 16 percent. Twenty billion dollars or more each year in interest and dividend income goes unreported.

There is little question that compliance is substantially higher under a withholding system than under a system of information reporting only. We therefore believe the time has come for imposing withholding on interest and dividend income as long as the costs to withholding agents of implementing this system are not excessive. For that reason, the Administration has proposed withholding on interest and dividends. Thus, while improving and extending the information reporting network is desirable, particularly to the extent that U.S. Government and corporate bearer obligations would become subject to reporting, we believe that the tax gap has grown too large for us to continue to take limited incremental steps toward improved taxpayer compliance in the interest and dividend area.

The balance of the bill's provisions broadening the scope of information reporting call for: (1) reporting on charged tips; (2) reporting by State and local governments on tax refunds; and (3) issuance of regulations requiring reporting by commodities and securities brokers. Let me discuss these proposals in turn.

<u>Charged Tips</u>

Employees who receive tips of $20 or more in a month are required under present law to report such tips to their employer. The employer, in turn, is required to report to the IRS (and to the employee) the amount of tips reported by the employee. The employer is similarly obligated to withhold tax on tips reported by the employee.

Tips are clearly compensation and thus constitute taxable income. Current estimates show that employees report less than 20 percent of their tip income. This is simply unsatisfactory taxpayer compliance. S. 2198 would require employers to treat tips that are charged on a credit card, and paid over by the employer to an employee, as wages subject to information reporting. Small employers, who are defined as those who normally had five or fewer employees during the preceding calendar year, would be exempt from this

reporting requirement. Since a paper record is already generated by the credit card transaction, there should be little additional paperwork burden as a result of this requirement; it is therefore desirable to impose information reporting in these circumstances.

State Tax Refunds

Taxpayers are required to include in income the amount of any State or local income tax refund, if the tax was deducted in a prior year, and the deduction gave rise to a tax benefit. Frequently, however, taxpayers fail to include these refunds in income. Doubtless this noncompliance sometimes results from taxpayer ignorance of the requirements of substantive law. In addition, we believe that taxpayers often completely overlook the fact that they received a refund in the prior year, or lack the particulars about the refund when they fill out their income tax returns. S. 2198 would go far to remedy both of these problems. Receipt of information reports from the States and local taxing jurisdictions would heighten taxpayers' awareness that the refunds are taxable. Additionally, the requirement would provide taxpayers with a timely paper record of the information which they require.

Although this provision is clearly desirable from the point of view of Federal tax administration, we must tread carefully in imposing a requirement of even this limited nature on State and local governments, if for no other reason than out of concern for the costs to the States of complying with these new reporting requirements. We note, however, that there has been a proliferation of information exchange agreements between the Federal and State governments. It is anticipated that many States would satisfy their obligations under this provision of S. 2198 by simply providing the information called for by current agreements (although information would also be required to be provided to the individual taxpayer, a practice that is not now in effect). It thus appears that it would not be unduly burdensome to ask the States and local governments to take the further step of insuring that taxpayers have the needed records concerning State tax refunds to complete their Federal tax returns.

Reports by Securities and Commodities Brokers

The tax law has long provided the Internal Revenue Service with authority to require reporting by brokers of the profits and losses and other information concerning their

customers. At present, there are no such requirements in effect. S. 2198 would mandate the issuance of regulations requiring information reporting by commodities and securities brokers on capital transactions, as well as the sale or transfer before maturity of any bond or other evidence of indebtedness (other than Treasury Bills or commercial paper sold or transferred by corporations). In its present form, S. 2198 would require that this information be reported only to the IRS, not to the taxpayers involved. In our view, a substantial part of the value of reporting lies in the fact that it informs taxpayers of their taxable income -- in this case, gains and losses on securities and commodities transactions. The failure of taxpayers to receive this information could well account for the very high rate of noncompliance -- 56 percent -- for capital transactions generally. If reporting of capital transactions is to be mandated, we hope the Committee will give careful consideration to the desirability of furnishing information to taxpayers as well as the IRS.

In cases where a brokerage house does not possess all of the information necessary for the taxpayer to compute gain or loss on a given item, we would anticipate that regulations would simply require that the brokerage house report the information that it has. For example, in the case of a customer who brings a security to a brokerage house for sale, the brokerage house would report the sale proceeds. While this would not provide full information on the amount of gain or loss from this transaction, it would give the IRS sufficient information to determine that the full proceeds were correctly reported, and would fully inform the taxpayer of the sale transaction, requiring only that he ascertain his tax basis to report the transaction correctly.

The extremely poor rate of compliance for capital transactions generally leads us to the conclusion that information reporting by securities and commodities brokers is desirable. However, we would like an opportunity to consider certain questions that are raised by this provision. First, we would wish to consider the types of information that would be useful to IRS in improving compliance in this area. Second, we would like to examine the costs both to the brokerage industry and to the IRS of producing information that would be useful to the Government and taxpayers. We look forward to working with you and representatives of the brokerage industry to develop answers to these questions.

Reporting In Machine-Processable Form

S. 2198 would permit the Commissioner to require that tax returns be filed in a machine-processable form, including on magnetic media in the case of a person who is required to file multiple returns. It is substantially simpler and cheaper for the IRS to process documents filed in machine processable form. Many persons filing large numbers of returns now voluntarily report in magnetic form. Reporting on magnetic media is typically no more expensive (and often less expensive) than reporting on paper. At a time when businesses are increasingly relying on computers to perform basic information processing functions, it seems appropriate to confirm that the Commissioner may require reporting in this manner, recognizing that it will be necessary to employ a flexible approach to take into account situations where persons do not have computer capability.

Penalty Provisions

Penalties in a voluntary tax compliance system must have two basic characteristics. First, the penalties must deter taxpayer behavior that would impair the voluntary tax compliance system; persons who purposely or recklessly fail to comply with the tax law must be subject to sanctions. Second, penalties must take into account, through abatement processes or otherwise, reasonable errors or omissions made in good faith. This second element is particularly important given the degree of complexity of our tax laws.

Although most taxpayers wish to pay their fair share of taxes, there is an institutionalized minority that relies on flaws in the existing penalty structure to avoid taxes. This avoidance results, in part, from the opportunity under current rules to take highly questionable or aggressive positions on tax returns with knowledge that even if the position taken is struck down, no penalty will be imposed on the resulting tax deficiency so long as a "reasonable basis" for the position taken exists. Because only a small percentage of returns are audited each year, these aggressive positions may never be scrutinized or questioned by the Internal Revenue Service (although it is true that IRS audits a relatively high percentage of certain returns based on selection techniques indicating a high probability of a substantial audit adjustment). Thus, the combination of the audit lottery and the absence of effective penalties makes it profitable for taxpayers to reduce their tax liability

through aggressive positions on their tax returns which masquerade as good faith constructions of the tax law. Revision of the penalty structure is thus clearly in order.

Some progress has been made in dealing with abusive taxpayer behavior of this sort. An over-valuation penalty was added by the Economic Recovery Tax Act of 1981 to deter taxpayers from claiming exaggerated deductions or credits based on an overstated valuation of property. As structured, the penalty will apply if the claimed value of property exceeds 150 percent of its true value; appraisal reports or opinions of experts will not, in general, prevent application of the penalty.

Audit Lottery Penalty

S. 2198 would impose an "audit lottery" penalty equal to 10 percent of an understatement of tax liability if the understatement is substantial. A substantial understatement is defined as 10 percent of tax liability, but at least $5,000 for individuals, subchapter S corporations and personal holding companies, and $10,000 for other corporations. In computing the understatement, items giving rise to a deficiency would be treated as having been reported properly and full tax paid thereon if the taxpayer adequately disclosed on the return or an attachment to the return that the reporting of the item was questionable. Thus, taxpayers who are uncertain about the resolution of an issue may continue to take "reasonable basis" positions, just as under existing law. Taxpayers would, however, be required to disclose to IRS the fact that the questionable or aggressive position has been taken or else face the possibility that this penalty would be imposed.

I applaud the sponsors of S. 2198 for squarely facing the difficult issue of overly aggressive returns filed by taxpayers attempting to take advantage of perceived weaknesses in our voluntary compliance system. It is important to reverse the perception among some taxpayers that adopting aggressive tax return positions is necessary or appropriate to avoid "overpaying" taxes relative to other taxpayers. The audit lottery penalty would undoubtedly go far in reducing that perception.

There are certain aspects of this penalty that we believe are in need of careful consideration. Whether adequate disclosure has been set forth in a tax return may be difficult to resolve in certain cases. Also, we wonder if

application of the penalty might be inequitable in cetain circumstances, such as in the case of ill-informed taxpayers. We would like to work with this Committee to fashion a penalty that would avoid or minimize these difficulties.

Corporate Officer/Agent Fraud Penalty

The second penalty measure of S. 2198 that I wish to review in detail is the corporate officer/agent penalty for participation in the tax fraud of a corporation. Under this provision, a corporate officer, director, or employee, as well as a corporate agent, would be liable for a civil penalty equal to 50 percent of an underpayment of tax by a corporation if the corporate officer or agent "knowingly participated" in the fraud. Knowing participation would include direct participation in the fraud by the individual, ordering a subordinate (whether or not the subordinate was employed by the corporation) to participate in the fraud, or knowing of and not attempting to prevent participation in the fraud by a subordinate. However, conduct would constitute "knowing participation" only if the individual knew or should have known that the participation would result in an underpayment of tax.

Under present law, corporate officers are subject to criminal penalties but not civil penalties for participating in the tax fraud of a corporation. Agents who are tax return preparers may be subject to civil liability of $500 for participating in such fraud. The unavailability of civil sanctions against corporate officers for participating in the fraud of a corporation leaves the IRS without an effective civil remedy against corporate officers who engage in conduct constituting tax fraud of a corporation. While a civil fraud penalty may be asserted against the corporation itself, the burden of such a penalty is borne by the shareholders; particularly in the context of a publicly held corporation, the corporate officer might not feel the "sting" of that penalty.

Initially, the issue of the overlap of the return preparer penalties and the corporate officer/agent penalty should be clarified. Presumably, the amount of any corporate officer/agent fraud penalty should be reduced by the amount of any return preparer penalty. Second, we wonder whether a penalty of $100,000, particularly in the case of relatively low-level employees, may be somewhat high. Aside from these issues, however, the penalty is, in our view, soundly conceived. Conduct amounting to tax fraud committed by a

person doing business in noncorporate form would give rise to a civil fraud penalty. It is difficult to see why a different result should obtain merely because the business is carried on in corporate form. Therefore, we view the concept of this penalty as a logical and necessary supplement to the Code provisions dealing with tax fraud.

Penalties for Failure to File Returns or Provide Taxpayer Identification Number

The bill provides for a series of revisions to the penalty provisions relating to information reporting, and adds a withholding requirement in the situation where no social security number or other taxpayer identification number is provided to a payor, or where an incorrect taxpayer identification number is provided to a payor, after the IRS has notified the payor that the number is incorrect. Briefly, these provisions are as follows:

- Where a person fails (1) to furnish a taxpayer identification number to a payor, (2) to include a taxpayer identification number in a return, or (3) to include the taxpayer identification number of another person in a statement or return filed (e.g., A's failure to include B's social security number on a Form 1099 issued to B), the $5 penalty provided under present law would be increased to $50, with a maximum of $50,000 (increased from $25,000) for all such failures during a calendar year. Where the failure to include another person's taxpayer identification number in a return filed is intentional, the penalty would be $100 per failure, with no limit.

- Where a payor fails to file an information return on dividends, interest or other amounts, the penalty would be increased from $10 to $50 per failure, but not to exceed $50,000 (increased from $25,000). If the failure to file such returns is due to intentional disregard of the filing requirements, the penalty would be 10 percent of the amount of the payment (5 percent in the case of reports by brokers).

- If a payee fails to provide a taxpayer identification number to a payor, withholding at the rate of 15 percent would be required. Alternatively, if IRS determines that the taxpayer identification number provided to the payor is incorrect, the payor would

start withholding upon notice from the IRS that the taxpayer has failed to supply the correct taxpayer identification number. Withholding would continue as long as the taxpayer fails to provide a number, or does not correct an incorrect number.

Persons should not be able to disregard or deliberately avoid information reporting responsibilities with the expectation that a failure to report income will provoke, at most, trivial sanctions. S. 2198 goes far to making the various Code reporting requirements meaningful by generally increasing the penalties for refusals to comply. I would like to comment on two of these penalty provisions.

The minimum penalty of 10 percent of the amount subject to the reporting requirement (5 percent in the case of reports by brokers) where a payor intentionally disregards the filing requirements would in some cases result in a substantial penalty. However, we think significant penalties are appropriate where parties knowingly attempt to subvert the reporting requirements that are crucial to the functioning of our tax system.

Next, let me mention the "penalty withholding" provision. Many information reports which are received either lack a taxpayer identification number altogether, or show an incorrect number. Fully 11 percent of the reports on dividends and interest payments lack this information. These defective reports are in many cases worthless to the Internal Revenue Service; those reports that are corrected are done at very substantial expense. By implementing a system of source withholding on persons who are not willing to provide correct taxpayer identification numbers, this provision will place the onus of correct information reporting on the person best able to insure that the reporting is accurate.
We think this is an appropriate and desirable sanction.

<u>Minimum Penalty for Extended Failure to File</u>

Under present law, a person who fails to file a tax return on a timely basis is subject to penalties based on a percentage of the amount of tax due. Thus, where no tax is due, no civil penalty can be assessed. In many cases, IRS finds it necessary to seek out persons who have failed to file their tax returns, in order to obtain such persons' returns. Many of these persons ultimately are entitled to refunds. In those cases, IRS' efforts to compel the filing are not recompensed, except for the value of the right to use

the refund without interest expense (assuming IRS pays the refund within 45 days after the return is filed). S. 2198 addresses this problem by imposing a minimum late filing penalty of $100 when a return is filed more than 60 days after the return due date (including extensions).

We have two reservations about this provision. Initially, we are concerned about the effect of codifying a rule allowing late filing by 60 days. Although we recognize that there could be substantial practical problems in applying this penalty without a grace period, we are not persuaded that Code-sanctioned late filing is a desirable rule of law.

Second, we are concerned that application of the penalty could give rise to a perception of government insensitivity in certain cases where a penalty was applied to poorly-informed persons; however, a liberal construction by IRS of the "reasonable cause" exception to the penalty would go far toward allaying those concens.

<u>Relief From Criminal Penalty for Failure to File Estimated Tax Return Where Exceptions Applicable</u>

Under present law, the obligation to file an estimated tax return, and the criminal sanction for failure to file such a return, are not correlated with the exceptions to the penalty for underpayment of estimated tax liability. Thus, a sanction for failure to file an estimated tax return may exist for a person who would incur no penalty for underpayment of estimated taxes because one of the statutory exceptions is applicable. S. 2198 would conform the rules imposing criminal liability for failure to file a return to the exceptions from liability for underpayment of estimated taxes. We support this provision.

<u>Interest Computation Method</u>

S. 2198 provides a number of adjustments to the Internal Revenue Code interest computation provisions, which apply both to interest due to IRS as well as interest due to taxpayers. In our view, these changes are appropriate and welcome.

<u>Compounding of Interest</u>

At present, interest under the Internal Revenue Code is computed on a simple rather than a compound basis.

Particularly in the case of an underpayment or overpayment that is outstanding for several years, the simple interest computation has the effect of greatly understating the amount of interest due.

For example, 15 percent simple interest for 1 year is equivalent to 14.5 percent interest compounded semi-annually -- not a significant difference. However, 15 percent simple interest for 5 years is equivalent to only 11.5 percent interest compounded semi-annually. For 10 years, a compounded rate of 9.4 percent is equivalent to 15 percent simple interest. Thus, for debts outstanding for longer periods, simple interest -- even at a high rate -- does not provide adequate compensation for the use of money. As a result, the absence of a compound interest rate in the Code discourages prompt settlement of disputes and prompt payment.

S. 2198 would require interest to be compounded semi-annually. This would bring the tax interest computation into line with modern commercial practice, and would insure that both taxpayers and the Government are treated fairly when they are in a position to receive interest payments. This is a change that is long overdue. We do wish to point out, however, that taxpayers who compute their own interest on deficiencies could have some difficulty in doing so when a compound rate is employed. We would like the opportunity to further consider wheather it would be appropriate to use simple interest, rather than a compound interest computation, for deficiencies that are outstanding for a relatively short period of time.

Interest Rate Adjustments

Under present law, the interest rate applicable to tax deficiencies and overpayments is adjusted each January 1 effective for the ensuing calendar year to a rate equal to 100 percent of the average prime rate in effect during September of the preceeding year, rounded to the nearest full percentage. This rule was adopted as part of the Economic Recovery Tax Act of 1981. Prior to the 1981 Act, the rate was adjusted every two years, based on a rate equal to 90 percent of the prime interest rate.

S. 2198 would provide for semi-annual adjustments to the interest rate, based on the average prime rate charged by banks (rounded to the nearest full percentage) during the six-month period ending three months prior to the date of the change.

I think it is important that we not let our basic concerns about high interest rates, and large fluctuations in interest rates, affect our analysis of the proper interest rate to be charged on tax overpayments and deficiencies. Regardless of the formula employed to fix interest rates, during periods when there are significant interest rate fluctuations, the possibility of significant differences between the interest rate determined under the formula and a market interest rate will exist. Under many circumstances, however, the proposed interest formula will yield an interest rate that more closely approaches a market rate than the formula provided under present law.

Restrictions on Payment of Interest

In a study by the General Accounting Office, it was pointed out that taxpayers who file a late return are able to earn interest on a refund from the due date of the return if the IRS is not able to process the return within 45 days after receipt. The GAO perceived this to be a potential abuse, and we agree. S. 2198 would change this result by providing that interest would be paid only from the date on which a tax return is filed, if it is filed late. Although interest is compensation for the use of money over time, the principle that interest should not generally be paid on a refund is presently established in the tax law -- no interest is due unless IRS fails to pay the required refund within 45 days of the date that the return is filed. The proposed change would not diminish the Service's incentive to issue refunds promptly; it would merely deny a windfall benefit to taxpayers who might deliberately delay filing their return, hoping that the IRS will miss the 45 day deadline. We think, therefore, that this is a desirable change.

In the same vein, S. 2198 provides that interest will be computed only from the date that a return is received by IRS in "processable" form. For a variety of reasons IRS unfortunately receives a number of returns each year which it cannot process through its system. Although IRS prefers to work with taxpayers to rectify filing deficiencies, it is not equitable for IRS to be burdened with the obligation of dealing with such a return within the 45-day period. Therefore, it is appropriate to limit the IRS' obligation to pay interest on overpayments after 45 days following filing of a return so that the return is not be considered filed until it is received in a processable form.

Finally, the bill would limit interest on refunds resulting from operating loss and capital loss carrybacks as well as tax credit carrybacks. Under present law, interest on a refund resulting from such a carryback is computed commencing with the first day of the taxable year following the year in which the loss or credit giving rise to the carryback occurs. We understand that some taxpayers might seek to take advantage of this rule, particularly in the context of the current high interest rates applicable to overpayments, to delay filing a refund claim, thereby earning interest on the tax refund in excess of what they might earn at a bank or other financial institution. S. 2198 would provide that interest on an overpayment resulting from such a carryback would be computed from the date on which a claim for refund is filed, except that interest accruing prior to March 12, 1982 would not be affected.

Although we think the tax system should not create artificial incentives to defer filing of a tax refund claim, some persons have asserted that the rule proposed by S. 2198 would unduly restrict the payment of interest to taxpayers who are unable to file their returns, and, therefore, their refund claims, prior to the due date of the return for the loss or credit year. Therefore, we would like to work with this Committee to insure that there would not be inequitable application of this rule in some cases.

Withholding on Retirement Plan and Annuity Distributions

S. 2198 would impose reporting requirements on employers who maintain qualified pension, profit-sharing, stock bonus and annuity plans and on administrators of such plans; would extend the withholding system to total distributions, and, on a voluntary basis, to periodic payments from qualified retirement plans, individual retirement accounts and commercial annuities; and would reverse the thrust of the current withholding system for distributions by such plans by requiring that a recipient be subject to withholding unless he elects not to have withholding apply. Subject to certain technical changes, we support these provisions of S. 2198.

Current Law

The basic principle that underlies the taxation of distributions from qualified retirement plans or commercial annuities is a familiar one: Distributions that exceed the recipient's basis are generally includible in income in the year received. However, the rules for determining the

recipient's basis are often complex, and significant exceptions to the general rule exist. As a result, taxpayers often do not understand the extent to which distributions constitute taxable income. The problem is compounded by the current withholding system and exacerbated by inadequate reporting requirements.

Under current law, there is no mandatory or voluntary withholding on total or lump sum distributions. Thus, the recipient of such a distribution may find it necessary either to increase wage withholding or to make estimated tax payments in order to avoid a penalty for underpayment of estimated taxes. In the case of periodic pension or annuity payments, withholding is possible, but only if it is requested by the recipient. Thus the current withholding system is partial, voluntary, and requires an affirmative act by the recipient.

In addition, the present information reporting system is not effective in providing taxpayers and the Internal Revenue Service with the information required to determine tax liability.

Reporting

The pension and annuity reporting requirements contained in S. 2198 would constitute important steps in closing the compliance gap. Under current law, a person who makes pension or annuity payments in excess of $600 or more in a taxable year must report such payments in accordance with Treasury regulations. Lump sum distributions from pension plans and commercial annuities are reported on Form 1099R while Form W-2P is used in the case of periodic payments. These forms are designed to provide taxpayers and the Internal Revenue Service with the information needed to calculate the individual's income tax liability. However, in many cases, the party making the payment has no access to the required information. For example, in order to compute the capital gains portion of the recipient's distribution, it is necessary to know when the recipient's plan participation began and when it ended. In most cases, that information is in the possession of the plan administrator, rather than the bank trustee or insurance company making the payments. While employers and plan administrators generally provide recipients with the required information, there is no statutory obligation that they do so. Under S. 2198, plan administrators would be required to provide both the recipients of distributions and the Internal Revenue Service

with the information needed to determine income tax liability. We believe it is imperative that such an obligation be imposed on plan administrators, and we therefore support this portion of S. 2198.

Withholding on Periodic Payments

S. 2198 would also institute a new system of voluntary withholding on periodic benefit payments under qualified plans or commercial annuities. These provisions would apply to typical pension or annuity payments that are made for a specific number of years or over the recipient's lifetime. The taxable portion of these payments, which is the amount attributable to employer contributions, would be subject to withholding as if it were wages.

The withholding system on periodic payments would be voluntary; the recipient could elect on an annual basis not to have withholding apply. Payors would be required to notify recipients of the opportunity to elect out of the withholding system.

We support these measures to make it easier for pension recipients to use withholding and to avoid the obligation to make estimated tax payments and unanticipated tax burdens at the end of the year. However, we have some concern that the notice provisions of the bill may impose undue burdens on plan administrators. We would be happy to work with this Committee to insure that these provisions pose the minimum administrative burden consistent with informing pension recipients of their right not to have withholding apply.

Withholding on Total Distributions

S. 2198 would also impose withholding on the taxable portion of a "total distribution." A total distribution is a distribution within one taxable year to the recipient of the balance to his credit under an eligible retirement plan or commercial annuity. As with periodic payments, only the taxable portion of the distribution would be subject to withholding. However, unlike withholding on periodic distributions, withholding on total distributions would be mandatory unless the recipient notified the payor that the distribution would be rolled over to an individual retirement account (IRA) or a qualified plan. Further, withholding would be calculated on the basis of the ten-year averaging rules of section 402(e) of the Code. This will generally result in lower withholding than if normal wage withholding tables and computational procedures were used.

We generally support the withholding system that would apply to total distributions. Specifically, we agree that it is appropriate to institute withholding on these payments; we believe that an exception for rollovers must be made; and we believe that use of the ten-year forward averaging rates on total distributions is an appropriate way to minimize overwithholding.

Other Provisions

Issuance of Regulations

Under S. 2198, the Internal Revenue Code would be amended to require that rules and regulations necessitated by future Code amendments be issued "as soon as possible." I am not certain of the purpose for this provision. I have no hesitancy in saying that Treasury and IRS today issue all regulations "as soon as possible." Continual changes in the law, the need to carefully consider technical and policy issues presented in the interpretation of complex statutory provisions, and the need to carefully consider the views of affected taxpayers, all delay the issuance of regulations. While I share the general concern about the backlog of regulations projects, I am uncertain about the desirability of writing this measure into the public law.

Effective Dates

I have not in this statement attempted to systematically comment on the effective date of each of the many provisions of S. 2198. I do wish to note, however, that it appears to us that early effective dates for certain of the provisions -- particularly, for example, where new reporting requirements are involved -- could create hardships for persons required to comply with the requirements, as well as for the Internal Revenue Service, in preparing to comply with these measures. Just as an example, I note that interest paid after December 31, 1981 on obligations of corporations issued in bearer form would be subject to reporting for the first time. Obviously, it would be difficult to comply with this requirement in many cases.

We would be happy to work with the Committee in devising effective dates for these provisions which adequately take into account practical difficulties which could arise in implementing some of the bill's provisions.

OMB Oversight

The last provision of S. 2198 that I would like to mention is section 202(b), which would eliminate oversight by the Office of Management and Budget over certain Treasury functions, particularly those discharged by IRS, under the Paperwork Reduction Act of 1980.

The Administration is still considering the application of the Paperwork Reduction Act to Treasury and IRS, and respectfully requests an opportunity to advise the Committee of its views at a later time.

Revenue Estimates

The Office of Tax Analysis in the Treasury is currently in the process of estimating the revenue effects of the bill's provisions. These estimates are expected to be completed within the next three weeks. We will furnish these estimates for the record as soon as they are available.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE March 22, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 4,804 million of 13-week bills and for $4,800 million of 26-week bills, both to be issued on March 25, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 24, 1982			:	26-week bills maturing September 23, 1982		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.837	12.513%	13.10%	:	93.630	12.600%	13.64%
Low	96.821	12.576%	13.17%	:	93.577	12.705%	13.77%
Average	96.827	12.553%	13.14%	:	93.593	12.673% 2/	13.73%

Tenders at the low price for the 13-week bills were allotted 12%.
Tenders at the low price for the 26-week bills were allotted 53%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 76,335	$ 44,835	:	$ 62,915	$ 56,415
New York	11,676,245	4,154,215	:	8,604,925	3,898,825
Philadelphia	38,600	36,535	:	25,030	25,030
Cleveland	64,580	42,080	:	79,050	61,050
Richmond	40,350	37,005	:	51,370	51,370
Atlanta	53,480	50,250	:	57,905	53,655
Chicago	804,490	101,640	:	627,880	132,880
St. Louis	34,205	23,125	:	31,360	27,360
Minneapolis	19,995	10,995	:	29,875	21,875
Kansas City	60,695	40,715	:	43,310	41,040
Dallas	27,485	22,485	:	22,475	22,475
San Francisco	629,630	69,630	:	666,365	174,365
Treasury	170,935	170,935	:	233,775	233,775
TOTALS	$13,697,025	$4,804,445	:	$10,536,235	$4,800,115
Type					
Competitive	$11,446,550	$2,553,970	:	$ 8,102,095	$2,365,975
Noncompetitive	964,420	964,420	:	886,640	886,640
Subtotal, Public	$12,410,970	$3,518,390	:	$ 8,988,735	$3,252,615
Federal Reserve	1,195,855	1,195,855	:	1,000,000	1,000,000
Foreign Official Institutions	90,200	90,200	:	547,500	547,500
TOTALS	$13,697,025	$4,804,445	:	$10,536,235	$4,800,115

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.621%.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-204

File Copy

FOR IMMEDIATE RELEASE
Monday, March 22, 1982

CONTACT: Robert Don Levine
(202) 566-2041

SECRETARY REGAN ON THRIFTS TO THE DIDC

TODAY, THIS COMMITTEE WILL AGAIN BE DISCUSSING PROPOSALS THAT WILL HELP DEPOSITORY INSTITUTIONS COMPETE FOR FUNDS WITH ORGANIZATIONS PAYING MARKET INTEREST RATES. I AM PLEASED TO NOTE THAT SINCE THE LAST COMMITTEE MEETING, THRIFT INSTITUTIONS HAVE EXPERIENCED A MODEST INCREASE IN NET NEW DEPOSITS. THE MAJOR CONTRIBUTION TO THIS INCREASE HAS BEEN FROM DEPOSITS WHOSE RATE CEILINGS WERE ELIMINATED, OR RAISED TO NEAR MARKET LEVELS, BY THE DIDC IN 1981. I KNOW THAT THE COMMITTEE WILL CONTINUE ITS EFFORTS TO INSURE THAT THRIFT AND OTHER DEPOSITORY INSTITUTIONS HAVE ADEQUATE FUNDS WITH WHICH TO CONDUCT THEIR BUSINESS.

WHILE MANY THRIFT INSTITUTIONS ARE HAVING FINANCIAL DIFFICULTIES IN THE CURRENT ECONOMIC ENVIRONMENT AND SOME MAY HAVE TO MERGE WITH STRONGER INSTITUTIONS, THERE SHOULD BE NO PUBLIC CONCERN ABOUT THE VIABILITY OF THIS INDUSTRY. THE EXISTING RESOURCES OF THE FEDERAL DEPOSIT INSURANCE AGENCIES ARE ADEQUATE TO DEAL WITH ANY PROBLEM

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INSTITUTIONS AND THESE RESOURCES WILL BE EXPANDED IF THE NEED ARISES. THIS ADMINISTRATION'S POLICY IS, AND WILL BE, THAT THE FEDERAL GOVERNMENT WILL TAKE ALL NECESSARY STEPS TO ASSURE THAT THE FEDERAL DEPOSIT INSURANCE CORPORATION AND THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION WILL BE ABLE TO MEET THEIR COMMITMENTS TO SAFEGUARD THE INTEGRITY OF EACH INSURED DEPOSITOR'S FUNDS IN A THRIFT INSTITUTION OR COMMERCIAL BANK.

TREASURY NEWS

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For Release Upon Delivery
March 23, 1982

Remarks by
Donald T. Regan
Secretary of the Treasury
Before the
Union League
Philadelphia, Pennsylvania
March 23, 1982

"Responsibility and Capitalism"

I need hardly tell you what a pleasure it is for me to be here this afternoon. The Washington press corps is fond of calling me the Reagan Administration's ambassador to Wall Street. They overlook my personal fondness for Walnut Street. I am delighted to be back in Philadelphia to see old friends and renew old ties in this city that was my home for ten years.

I also have cherished memories of this hall, dedicated to the greatest of Americans, by an organization dedicated to his memory and his ideals. I think of Lincoln often, peering through the smoke and division of civil war, seeing history beyond the horizon.

"We cannot escape history," he said in the darkest days of battle. "We of this Congress and this Administration will be remembered in spite of ourselves. No personal significance, or insignificance, can spare one or another of us. The fiery trial through which we pass will light us down in honor, or dishonor, to the latest generation. We, even we here, hold the power, and bear the responsibility."

Responsibility can be a heavy load, a double-edged sword, or the key that unlocks the door to tomorrow. None of us can escape it. All of us, as Lincoln said, will be remembered in spite of ourselves. So this afternoon, I'd like to spend a few minutes on the subject of responsibility. I'd like to share some straight talk with some old friends. Earlier today, I spoke at Bucknell University on "The Morality of Capitalism." To me, the relationship is self-evident. For no other system in no other land has produced more abundance, more opportunity, more social mobility or more freedom. No other way of life provides a more equal distribution of profit or demands a broader assumption of responsibility.

The Reagan Administration echoes my belief. We recognize that there can be no security without risk, no prosperity without toil. We have set out to encourage the risktakers, and provide new incentives for those who would tap their own ingenuity in

creating jobs and restoring America's cutting edge in the world marketplace. We hold to the maxim first expressed by Theodore Roosevelt, eighty years ago...

"The first requisite of a good citizen in this Republic of ours," he said, "is that he shall be able and willing to pull his weight."

Our economic policies are designed to give every American the ability to pull his own weight. In the last fifteen months, we've made striking progress toward that goal. Think back to January, 1981 -- I know it's painful, but try it anyway. Americans on the eve of the Reagan presidency were suffering a double whammy of 12 percent inflation and the highest interest rates since the time of Lincoln. Government, already bloated, was merrily indulging itself, feasting on a stagnant economy and adding 14 percent a year to an ever-expanding waistline. Business languished in a regulatory straightjacket, starved for new capital, deprived of old markets.

A scent of hypocrisy lingered in the air, mixed with the stale aroma of the government printing press. For years, Washington had waged an ineffective war on poverty - without once trying to make peace with prosperity.

It had cheapened our currency, tarnished our ideals, and condemned millions of our people to unemployment lines and welfare lines instead of assembly lines.

It claimed a near-monopoly on compassion for the poor - yet did little or nothing to alleviate the suffering they felt every time they walked into a grocery store or drove up to a gas pump. So intent had government become in protecting us from ourselves, it didn't seem to mind that we had fewer dollars in our pockets, or less faith in our futures.

In a word, government had behaved irresponsibly. The extent of its failure could be measured in the numbers of economic activity - hardly a passing grade. President Reagan was determined to do better. In partnership with the Congress and the American people, he has charted a new course; not a midcourse correction, but a virtual U-turn. Again, let me resort to some numbers.

For the first time in four years, inflation has fallen below double-digit levels. Less than 9 percent for all of 1981, consumer prices will fall further this year, to around 7 percent or less. And if you don't believe me, take a look at February's producer price index, which registered the first actual drop in over six years.

Interest rates, while still too high, have declined by more than five points since the President took office. The tide of government regulation has itself been regulated; there were

23,000 fewer pages in the Federal Register last year than in 1980.

The rate of personal savings is up. The number of people employed by government at all levels is down. So, unfortunately, are the ranks of other jobholders. You don't need me to tell you we've been in a recession. I say "been" because of mounting evidence that the worst is behind us. Last month's sharp increase in retail sales - led by a 3 percent gain in durable goods - is just the latest and most encouraging sign that the economy is coming out of its slump.

Of course, we still have our critics, those mail-order prophets of doom who toss around words like "depression" and who probably would get a thrill out of shouting fire in a crowded theatre if they weren't so worried about getting trampled in the ensuing stampede.

But that's all right. We'll let them do their worst; we'll be content to do our best. It was Mark Twain who counseled a friend, "Always do right. This will gratify some people and astonish the rest." For fifteen months, this Administration has been doing right. A lot of people are grateful - and much of official Washington is still rubbing its eyes in disbelief. Imagine: a President who does in office what he said he would do on the stump; whose campaign promises turn into tax cuts, not tax increases; who is daring enough to utter words like "profit" and "incentive" right out loud. I think you'll agree with me: this is heady stuff.

I think you'll agree as well, that this President is living up to his responsibility to lead us away from the failed dogmas of fifty years' standing. He is leading a revolution -- without the support of some of those cautious businessmen who were at our side last summer, but who have since deserted the streets for the relative safety of their boardrooms. Of course, they run the risk of abandoning the field of battle to the counter-revolutionaries, those who have lain in wait for this chance to avenge their earlier defeat and restore business as usual -- that is to say, anti-business as usual.

For as long as I can remember, you and I have argued that government alone could not guarantee economic advance. We were right then -- and we are still right. Government could not tax and spend and regulate us to prosperity, and government cannot retrench its way to prosperity. Not alone. Not without the active participation of a private sector whose own authority to make decisions has expanded along with its tax base.

It has been said more than once that consumers will lead us out of the recession. We're seeing evidence of that already. Yet ultimately, any lasting recovery will depend on the decisions of investors and producers. Now uncertainty is never a spur to investing. And it's not surprising that much of the business

world has responded with caution to the economic program enacted last summer. According to the Commerce Department, capital spending plans for 1982 are expected to fall by about 1 percent. A more narrow survey by McGraw-Hill points to a larger dropoff; while the nation's largest manufacturers, according to the Conference Board, expect to post a 10 percent gain in capital spending this year.

Considering the numbers were compiled during the worst of the recession, that may not seem too bad. Compared with the 10 percent drop in capital spending that occurred in the 1975 recession, they may seem downright cheerful.

So why am I not smiling?

Because economic planning is an inexact science, influenced by and influential on current psychology. Such numbers have political ramifications. They can set a tone for recovery, or paint a bleak picture of the status quo. And in today's Washington, especially on Capitol Hill, there is a growing uneasiness about all this. There's a feeling that last year's most fervent believers in tax cuts have become this year's agnostics on the subject of business investment.

Even more than in the stock exchanges and brokerage houses, in the world of politics, appearances and realities are easily confused. Yet some realities are undeniable. This year alone, American business will recover around $13 billion as a result of the Economic Recovery Program passed by the Congress and signed by the President last summer. By 1986, that figure will rise to around $75 billion. With the infusion of cold cash comes a responsibility to use it wisely. The program President Reagan achieved last year is yours as well as ours. The cuts in taxes and spending, the accelerated cost recovery, the pursuit of deregulation and a slow, steady growth in the money supply: these are reflections of common priorities and long-frustrated preferences. You raised your voices, you rolled up your sleeves. You helped us to overcome the entrenched opposition of those who wouldn't recognize a budget surplus if it jumped over the Washington Monument.

Deficits are much in the news these days. Some of the capital's biggest spenders have taken to denouncing them as too large. I trust you'll forgive me for not joining in the crocodile tears.

Just last week, an informal poll of congressional committee chairmen forecast a 1983 budget nearly $30 billion higher than what the President has asked for. I think you have a responsibility to oppose such a cynical effort at budget-busting. I think you have a responsibility to ask the next congressman seen mopping his brow over deficits how he voted on synfuels and student loans and price supports. And I think you have a responsibility to demand straight talk from your elected

representatives -- on the subject of their own spending habits and on the subterfuge that equates a smaller deficit with lower interest rates. Of course, if they really cared about reducing the size of the deficit, they might face up to the need for further belt-tightening by Washington, rather than the individual consumer whose tax cut, after all, does little more than keep pace with the built-in appetite of inflation for more and more revenue.

The first responsibility of any capitalist is to himself -- to make a good product, and earn a fair profit. We have given you the tools to do both. Now we ask that you put them to work. We did not confuse October 1, 1981 with the Millenium. We did not expect overnight recovery or instant Utopia. At a time when inventories were high and plant utilization relatively low, it would have been unrealistic to anticipate an immediate surge of visible investment.

Yet there were lawyers and accountants poised to take immediate advantage of safe harbor leasing. Someone was planning something. And now is a time for making some additional plans that take into account the following factors:

-- Inventories are falling, and falling fast. By $3.4 billion in December, by an additional $2.1 billion in January. In tandem with the increase in consumer spending, there is solid ground for optimism.

-- Inflation, too, is coming down. This isn't due to any stroke of luck, nor any fortuitous mingling of random elements. On the contrary, the progress we've made in fighting inflation is due to fundamentals. Energy prices are down, and the oil glut shows no sign of vanishing. We're on the right track with wage negotiations, with a host of upcoming contracts pointing in the same general direction as the historic agreement between Ford and the U.A.W. And might I add here a note of praise to union leaders and rank and file members, who have seen and grasped their own responsibility to make our products more competitive and our plants and factories more efficient. They deserve prosperity; they already have the Reagan Administration's gratitude.

As far as the deficits are concerned, the President has signalled his willingness to look closely at any comprehensive package the Congress fashions as an alternative to his own. But our primary responsibility to the American people remains unchanged. We want to balance the budget -- but we must restore economic health first. And we cannot do the latter by imposing new taxes or retreating from the basic provisions of the President's program.

This is something the Business Roundtable, for one, ought to know. They should also be able to remember back a few years, to the presidencies of Gerald Ford and Jimmy Carter. In 1976, the

Ford Administration sustained a $66 billion deficit, the largest in U.S. history, and fifteen times the size of the '74 deficit. Yet during that same two year period, interest rates declined from 12 percent to less than 7 percent. The deficit run up in 1976 did not stall economic recovery. Far from it. Even with modest growth in the money supply, the economy grew at a vigorous clip for three more years -- until 1979, when the Carter Administration boasted a deficit cut to $27 billion -- and inflation and interest rates both doubled over their '76 levels.

What's more, those who conclude an automatic cause and effect relation between federal deficits and interest rates have conveniently left out of the equation the most potent single weapon in our economic arsenal -- the rate of personal savings. This year alone, we expect that private savings, which were running at $480 billion in 1981, will increase by $60 billion. By next year, the increase will reach $170 billion. By 1984, it will hit $260 billion, totaling $740 billion in 1984. And those numbers are far larger than anything glimpsed by even the gloomiest deficit-monger.

So let me suggest, as a member in good standing of the Hardheaded Businessman's Club, that your own primary responsibility to succeed mirrors the nation's need to retool, modernize and agressively pursue new ideas and new markets. Verbal assurances of longrange investment are not enough. As John Maynard Keynes used to say, "In the longrun, we're all dead." And he ought to know.

Your second responsibility is to the program itself. No team can expect to win for long if half the players refuse to leave the sidelines. Yet that is exactly what has happened with some advocates of the President's program. Having sought and achieved an atmosphere of stability and predictability within which to make longrange decisions, they now troop to Washington to beseech Congress to raise taxes. It won't wash.

Less defensible still are proposals to delay or cancel individual tax cuts while leaving business untouched. To be sure, this year's deficit might be reduced by a few billion dollars. But who can calculate the jobs uncreated, the businesses failed, the opportunities for expansion unrealized? It is narrow thinking at best to believe you can stimulate the economy by raising labor costs or by shrinking consumer savings power. It threatens both the labor supply and the pool of new capital on which we rely for lasting prosperity. It undermines the stability business itself seeks. It runs the risk of a severe political backlash.

It is the appearance of selfishness that aggravates public sensibilities. In fact, what the public demands is not far removed from what the Administration expects. We don't expect free enterprise to take over the social welfare system, but we do expect it to participate in the President's Private Sector

Initiatives program. We expect it to give generously of its knowhow, its imagination and its sweat equity. We expect it to join vigorously in our campaign to restore the inner cities and reclaim millions of young people for the system in which we place our faith. We expect an aroused business community to sustain our belief that it can be an engine of social progress and not one more sacred cow feeding at the Washington trough.

These are your responsibilities in the days ahead: to accept the risks and calculate the odds on America's economic rebirth; to consolidate the gains and know the political realities that have prevailed since passage of the President's program; to unleash your ingenuity on a troubled society as well as a revised tax code.

I hope these words don't sound too poetic. Because I know that when each of you go back to the grindstone -- when you take another look at the corporate ledger sheet -- you will be hit by the sobering reality of our economic situation. And I know that the profit and loss statement speaks to your daily concern for corporate performance. But I also know that the Reagan Administration and the business community have a unique opportunity: to reorient the government of this country and to reinstitute the marketplace as the driving force in our economy.

So I ask that as you consider short term versus long term objectives; as you consider the responsibilities of capitalism in our society; remember the words of Winston Churchill during the War.

He said, "Do not let us speak of darker days; let us speak rather of sterner days. These are not dark days; they are great days ... and we must all thank God that we have been allowed ... to play a part ..."

Let there be no mistaking the fact that in these days, during this debate, each of us can play a part. Together, we will put America back to work. We will give America back to those who make her work. That is our responsibility.

Thank you.

# # #

TREASURY NEWS

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FOR RELEASE ON DELIVERY
Expected at 10:00 a.m.
March 23, 1982

STATEMENT OF MARK E. STALNECKER
DEPUTY ASSISTANT SECRETARY OF THE TREASURY (FEDERAL FINANCE)
BEFORE THE SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
THE HOUSE COMMITTTEE ON BANKING, FINANCE AND URBAN AFFAIRS

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here this morning to discuss the objectives of public debt management and the financing techniques employed by the Treasury. I also want to discuss our concerns regarding certain limitations imposed by the Second Liberty Bond Act, the governing statute for Treasury debt management.

The public debt includes both marketable and nonmarketable securities issued by the Treasury. The tables attached to my statement present data on public debt securities and ownership over the last decade. The Treasury issues these securities to finance both budget deficits and off-budget deficits, including the borrowing needs of the Federal Financing Bank, and to refund maturing debt. My prepared statement will deal primarily with Treasury marketable securities, but I will also comment on the savings bond program and I will be happy to answer any questions you may have regarding other nonmarketable Treasury issues.

Marketing Techniques

Treasury marketable securities include (1) Treasury bills, which are sold at a discount and have maturities of less than 1 year; (2) Treasury notes, which have semiannual interest coupons and maturities from 2 to 10 years; and (3) Treasury bonds, which have semiannual coupons and maturities in excess of 10 years.

The Treasury currently sells all of its marketable bills and coupon securities in competitive auctions.

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Announcements and sales of regular 13-, 26- and 52-week bills are on a well-known schedule that varies only on holidays or when interrupted by Congressional inaction on debt limit legislation. With regard to coupon securities (notes and bonds), market participants are generally cognizant of the schedule of Treasury issues, because of the regularity of the new issue and maturity cycles. When the Treasury announces a sale of marketable securities, it makes its announcement of the amount and other terms of the sale available to the financial press and news wire services simultaneously, so that no news organization or market participant has the advantage of advance information. The Treasury announces its offerings far enough ahead of the sale dates to permit information to be disseminated to all interested parties.

The Treasury does not purchase advertising for its marketable securities, nor does it pay commissions to dealers who make markets in Treasury securities. Dealers and investors submit subscriptions to Treasury offerings directly to the Treasury or to Federal Reserve Banks and Branches which act as the Treasury's fiscal agency. Dealers in U.S. Government securities often are awarded the major share of issues in competitive auctions, and dealers subsequently distribute the securities to their customers. Dealer profits or losses on the transactions are determined by the difference between the price the dealer pays to the Treasury and the price the dealer receives from the customer. The dealer's capital is at risk in each transaction, since the dealership is trading for its own account.

The Treasury accepts noncompetitive tenders in Treasury bill and coupon auctions up to pre-announced limits for each investor at the average price of accepted competitive tenders. Allotments on noncompetitive tenders are made prior to awards on competitive bids. The purpose for accepting tenders on a noncompetitive basis is to achieve a wider distribution of the securities by attracting tenders from small banks and other investors who are generally thought to have limited access to up-to-date information on market conditions.

Regularization of Issues

Treasury debt management operations are directed to meeting the U.S. Government's daily cash needs in order to assure that sufficient funds are available to pay obligations when and as due, while providing a prudent cash balance. Our operations in the market are conducted so as to minimize disruption and thereby reduce the cost of our debt operations. Disruptive financing operations increase market uncertainty and hence the risk of purchasing securities, raising the rates paid on Treasury obligations. Treasury feels that the most important element in reducing market uncertainty about debt financing is the maintenance of a regular, predictable cycle of security issuance. Regularity of debt management removes a major source of market uncertainty,

and assures that Treasury debt can be sold at the lowest possible interest rate consistent with market conditions at the time of the sale.

Predictability of debt management is important for another reason, as well. Because Treasury securities are the benchmark for the Nation's fixed income market, Treasury mismanagement of the debt can destabilize the entire financial system. Treasury has raised large amounts in the market over the past few years. In FY 1979, net market borrowing amounted to $27.4 billion. This total rose to $83.6 billion in FY 1980, and to $90.5 billion last year. Although market interest rates were historically high during this period, Treasury financing operations, per se, did not disrupt the market. Leaving aside the issue of whether a given level of deficit financing raises interest rates, the conduct of debt management during this period prevented major market dislocations. If these massive borrowing requirements had been met in a haphazard manner, significant damage to the financial markets would have occurred. Unpredictable shifts of Treasury financing out of one sector of the market to another based on interest rate forecasts or other "opportunistic" rationales could have seriously damaged market confidence and driven rates significantly higher. This potential for damage to the market is yet another reason to pursue prudent, predictable debt operations.

The current regular issue "cycles" for Treasury financing through sales of bills, notes, and bonds began in the early 1970's and are still evolving. Treasury sells securities in all maturity ranges to meet the needs of the broadest possible array of investors. Establishment of this regular pattern has contributed to a positive market climate in several ways:

1) By creating a schedule of Treasury security auctions, different investors, as well as dealers, can plan portfolio strategies in advance.

2) By establishing the potential Treasury new issue calendar in advance, other issuers, including Federally-sponsored agencies and private borrowers, can plan their financing operations with more certainty.

3) By spreading Treasury maturities more evenly over time, market disruptions are lessened and future refunding and borrowing operations can be facilitated.

Not all Treasury borrowing can be done on this regular schedule, because there are seasonal flows in U.S. Government budget receipts and outlays. Receipts, for instance, tend to be concentrated in the April-June quarter. Seasonal borrowing to adjust for this mismatch in cash flows has been accomplished by selling cash management bills in the deficit period to mature in the cash surplus period. These bills are also used to bridge cash shortfalls resulting from an unanticipated drop in receipts or bulge in outlays. Nevertheless, regularity is a keystone of Treasury debt operations.

Long-Term Bonds

I would especially like to address the role of long bond issuance in the overall scheme of Treasury debt management and regularization. Long bond issuance is an integral part of Treasury's regularization of debt operations. Two bond sales are normally conducted each quarter, with a 20-year bond auction in the last month of the quarter and a 30-year bond sale as part of the mid-quarter refunding operation. The Treasury bond market is deep and liquid, with cash market trading aided by a well-developed futures market.

I would like to note at this point that the Treasury believes that the financial futures markets have on balance facilitated the management of the public debt, by shifting risk to those willing and able to bear it, by price discovery and dissemination, and by increasing the liquidity of the underlying cash market. A liquid cash market for Treasury securities is in Treasury's interest because it increases the attractiveness of its offerings, thus reducing the cost of servicing the public debt.

In addition to meeting the investment needs of long-term portfolio managers, sale of long-term obligations extends the average life of Treasury debt, which reduces the disruptive effects of frequent Treasury operations to refund maturing issues. Almost one half of outstanding marketable debt matures within one year (See Chart 1). This refunding need must be added to Treasury's new cash borrowing requirement to determine gross Treasury issuance in the market. Because of the short average maturity of outstanding Treasury debt (See Chart 2), long bond issuance must remain an integral part of Treasury's debt management policy.

Some observers have suggested that Treasury should avoid the sale of long-term securities when interest rates are "high," in order to avoid locking in high interest costs. However, any definition of "high" interest rates is extremely subjective and carries with it an implicit forecast of future interest rates. If Treasury "temporarily" withdrew from the bond market because it felt rates were "high," market reaction to reentry in the long market could well be that rates were "low." Thus, reentry could be interpreted as a government forecast of higher rates in the future. Management of the debt based on interest rate forecasts would create tremendous uncertainty as to Treasury's financing schedule and, over the long run, would result in higher costs to the Government by reducing the market's willingness to bid in auctions. Therefore, a consistent policy of debt issuance across the maturity spectrum must be maintained without regard to expected interest rate developments.

I would also note that, because of the large volume of maturing obligations refinanced each year, interest expense on the public debt is extremely sensitive to interest rate movements. This

adds volatility to the interest expense component of Federal outlays. As interest rates move up and down, Treasury's interest expense also rises or falls. As long as the debt outstanding retains this short-term character, debt extension must be a part of our debt operations.

At this point I would like to mention that market uncertainty has recently arisen because of Congressional inaction on Treasury's request to repeal the 4 1/4% ceiling on long bonds. The face amount of Treasury bonds held by the public with interest rates in excess of 4 1/4% may not exceed $70 billion. Treasury has exhausted this authority (See Chart 3). Unless Congress repeals the 4 1/4% ceiling, or grants additional issuing authority, no more bonds may be sold. In fact, Treasury would normally announce its regular auction of 20-year bonds today. It cannot do so because of Congressional inaction. Unless authority is granted in the next few weeks the usual sale of 30-year bonds as part of our May refunding is also in jeopardy. Inability to sell these securities has created dislocations in the market and raised questions about the Treasury's ability to carry out predictable, prudent debt management policies. I urge Congress to expedite the long bond authority legislation so that this uncertainty can be resolved.

United States Savings Bonds

I would like to turn now to our current proposal for the savings bond program. The Treasury has sent a request for expedited action on new savings bond legislation to the Chairman of the House Ways and Means Committee. Savings bond legislation is urgently needed to give savings bond investors a fair rate of return and to stem the cash outflow from savings bonds that the Treasury has sustained since late 1978 (Chart 4). Under existing law the Treasury is not permitted to offer an interest rate on savings bonds that will keep up with the interest rates available from other investments. The legislation Treasury submitted to Congress in January will remove the statutory interest rate ceiling on savings bonds and thus will enable Treasury to guarantee the small, long-term savings bond investor that the interest rate will always be reasonably in line with current market rates available to larger investors. This is the only way that we can revitalize the savings bond program.

A healthy savings bond program is not only good for small savers, it is good for the Treasury too. Even at the higher market-related rates we propose to pay to savings bond holders the costs to the Treasury will be somewhat less than the alternative cost of financing this debt in the open market. Thus, the longer we delay the introduction of the new variable rate savings bond, the greater the cost of financing the debt.

SUMMARY

A capsule summary of Treasury debt management policy is that it is most effective when it is least obtrusive. Debt extension, regularization of new issues and maturities, the use of auctions to sell new Treasury securities at prevailing market yields, the communication of Treasury financing needs to the public, and the maintenance of a viable savings bond program all help to minimize the potential disruptive effects of the Treasury's large refunding and new financing tasks, and to minimize the cost of financing the public debt.

Mr. Chairman, that concludes my prepared statement on debt management matters of primary concern to the Treasury, but I will be happy to answer any questions at this time.

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Table I

Changes in Interest-Bearing Public Debt Securities Held by Private Investors
(Calendar years, in billions of dollars)

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Total Debt Held by Public*	$246.0	$260.5	$259.7	$269.9	$348.4	$408.4	$459.2	$502.8	$539.4	$615.1	$693.1
Marketable	173.4	180.2	170.7	181.0	255.8	307.8	344.3	365.2	402.2	492.3	580.7
Bills	65.9	73.4	70.4	82.2	119.3	122.3	119.0	119.3	127.3	172.1	195.3
Coupons	107.5	106.8	100.5	98.8	136.7	185.6	225.3	245.9	274.9	320.2	385.4
Maturing in:											
under 1 year	15.9	17.6	22.9	18.1	30.8	35.2	53.0	54.9	63.1	67.5	80.0
1-5 years	60.7	57.6	50.9	54.2	74.7	103.8	119.5	128.3	133.2	159.6	188.4
5-10 years	16.9	17.5	13.2	13.5	16.7	31.0	32.8	33.6	36.6	41.2	50.9
10-20 years	6.6	9.6	9.1	8.7	8.5	7.4	8.3	13.8	19.8	27.3	34.1
20 years and over	7.3	4.4	4.3	4.3	5.9	8.2	11.7	15.3	22.3	24.6	32.0
Nonmarketable	72.7	80.2	88.9	88.8	92.5	100.6	114.9	137.5	137.1	122.8	112.4
Savings bonds & notes	54.9	58.1	60.9	63.8	67.9	72.3	77.0	80.9	79.9	72.5	68.1
Foreign series	16.8	20.6	26.0	22.8	21.6	22.3	22.0	29.6	28.8	24.0	19.0
State and local	---	---	0.4	0.6	1.2	4.5	13.9	24.3	24.6	23.8	23.0
Other	1.1	1.1	1.6	1.6	1.8	1.5	1.8	2.7	3.8	2.5	2.3
Memo: Holdings Federal Reserve Banks	62.1	70.2	69.9	78.5	80.5	97.0	101.2	109.6	117.5	121.3	130.9

Office of the Secretary of the Treasury

March 17, 1982

*Excludes U.S. Government accounts and Federal Reserve Banks' holdings of public debt securities.

Table II

Changes in Interest-Bearing Public Debt Securities Held by Private Investors
(Calendar years, in billions of dollars)

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Total Debt Held by Public*	$14.5	$-0.8	$10.2	$78.5	$60.0	$50.8	$43.6	$36.6	$75.7	$78.0
Marketable	6.9	-9.5	10.3	74.9	52.0	36.5	20.9	37.0	90.1	88.4
Bills	7.6	-3.2	11.9	37.1	3.0	-3.2	0.3	8.0	44.8	23.2
Coupons	-0.7	-6.3	-1.7	37.8	49.0	39.7	20.6	29.0	45.3	65.2
Maturing in:										
under 1 year	1.8	5.3	-4.8	12.7	4.4	17.8	1.8	8.2	4.4	12.5
1-5 years	-3.1	-6.7	3.3	20.5	29.5	15.7	8.8	4.9	26.4	28.8
5-10 years	0.6	-4.3	0.3	3.2	14.3	1.8	0.8	3.0	4.6	9.7
10-20 years	2.9	-0.5	-0.4	-0.2	-1.1	0.9	5.5	6.0	7.5	6.8
20 years and over	-2.9	---	---	1.6	2.3	3.5	3.6	7.0	2.3	7.4
Nonmarketable	7.6	8.7	---	3.7	8.0	14.3	22.6	-0.4	-14.3	-10.4
Savings bonds & notes	3.3	2.7	3.0	4.1	4.4	4.7	3.9	-1.1	-7.4	-4.4
Foreign series	3.9	5.4	-3.2	-1.2	0.7	-0.1	7.4	-0.7	-4.8	-5.0
State and local	---	0.4	0.2	0.6	3.2	9.4	10.4	0.3	-0.8	-0.8
Other	0.4	0.2	---	0.2	-0.3	0.2	0.9	1.1	-1.3	-0.2
Memo: Holdings Federal Reserve Banks	-0.3	8.6	2.0	7.4	9.0	4.2	8.4	7.8	3.8	9.6

Office of the Secretary
of the Treasury

March 17, 1982

*Excludes U.S. Government accounts and Federal Reserve Banks' holdings of public debt securities.

Table III

Ownership of Public Debt Securities by Private Investors*

Billions of Dollars

End of Calendar Year	Total Privately Held	Commercial Banks	Individuals: Savings Bonds	Individuals: Other Securities	Insurance Companies	Mutual Savings Banks	Corporations	State and Local Governments	Foreign and International	Other Investors
1970	$229.1	$62.7	$52.1	$29.1	$7.4	$3.1	$7.3	$27.8	$19.8	$19.9
1971	247.1	65.3	54.4	18.8	7.0	3.1	11.4	25.4	46.1	15.6
1972	261.7	67.7	57.7	16.2	6.6	3.4	9.8	28.9	54.5	17.0
1973	260.9	60.3	60.3	16.9	6.4	2.9	10.9	29.2	54.7	19.3
1974	271.0	55.6	63.4	20.8	6.2	2.5	12.4	29.2	58.8	22.1
1975	349.4	85.1	67.3	21.3	9.5	4.5	21.3	34.2	66.5	37.4
1976	409.5	103.8	72.0	29.6	12.7	5.9	26.1	41.6	78.1	39.7
1977	461.3	101.4	76.7	31.1	15.5	5.9	20.5	50.8	109.6	49.7
1978	508.6	93.2	80.7	33.3	15.7	5.0	19.6	64.4	137.8	58.9
1979	540.5	96.4	79.9	36.2	16.7	4.7	22.9	69.9	123.7	90.1
1980	616.4	116.0	72.5	56.7	20.1	5.4	25.7	78.8	134.3	106.9
1981	694.5	109.4	68.1	75.6	19.1	5.2	37.8	85.6	141.5	152.2

Percentage Distribution

End of Calendar Year	Total Privately Held	Commercial Banks	Individuals: Savings Bonds	Individuals: Other Securities	Insurance Companies	Mutual Savings Banks	Corporations	State and Local Governments	Foreign and International	Other Investors
1970	100%	27.4%	22.7%	12.7%	3.2%	1.4%	3.2%	12.1%	8.6%	8.7%
1971	100	26.4	22.0	7.6	2.8	1.3	4.6	10.3	18.7	6.3
1972	100	25.9	22.0	6.2	2.5	1.3	3.7	11.0	20.8	6.5
1973	100	23.1	23.1	6.5	2.5	1.1	4.2	11.2	21.0	7.4
1974	100	20.5	23.4	7.7	2.3	0.9	4.6	10.8	21.7	8.2
1975	100	24.4	19.3	6.1	2.7	1.3	6.1	9.8	19.0	10.7
1976	100	25.3	17.6	7.2	3.1	1.4	6.4	10.2	19.1	9.7
1977	100	22.0	16.6	6.7	3.4	1.3	4.4	11.0	23.8	10.8
1978	100	18.3	15.9	6.5	3.1	1.0	3.9	12.7	27.1	11.6
1979	100	17.8	14.8	6.7	3.1	0.9	4.2	12.9	22.9	16.7
1980	100	18.8	11.8	9.2	3.2	0.9	4.2	12.7	21.8	17.3
1981	100	15.8	9.8	10.9	2.8	0.7	5.4	12.3	20.4	21.9

Office of the Secretary
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*Includes small amounts of matured debt on which interest has ceased.

Chart 1

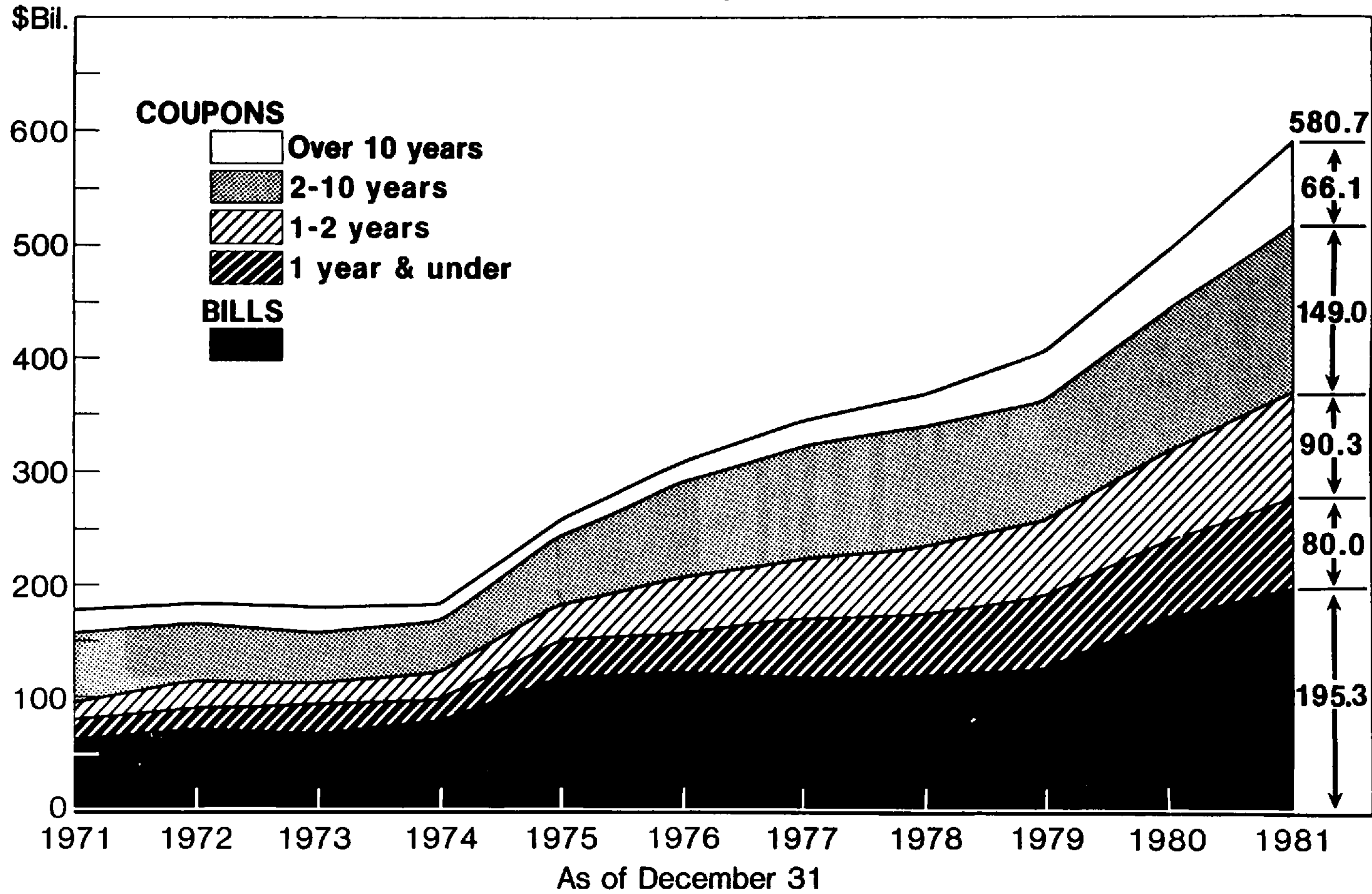
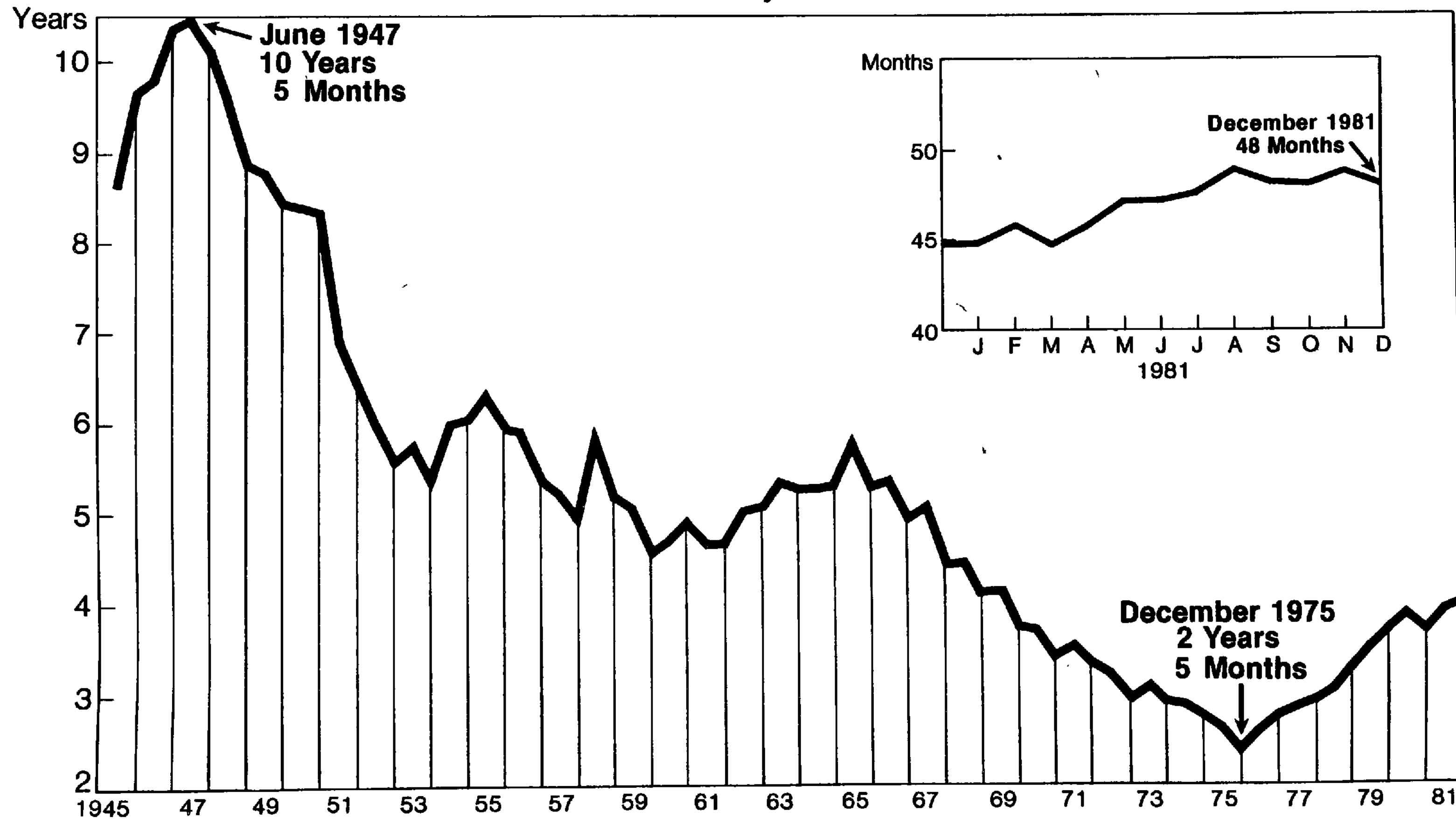


Chart 2



Office of the Secretary of the Treasury
Office of Government Financing

January 26, 1982-4

Chart 3

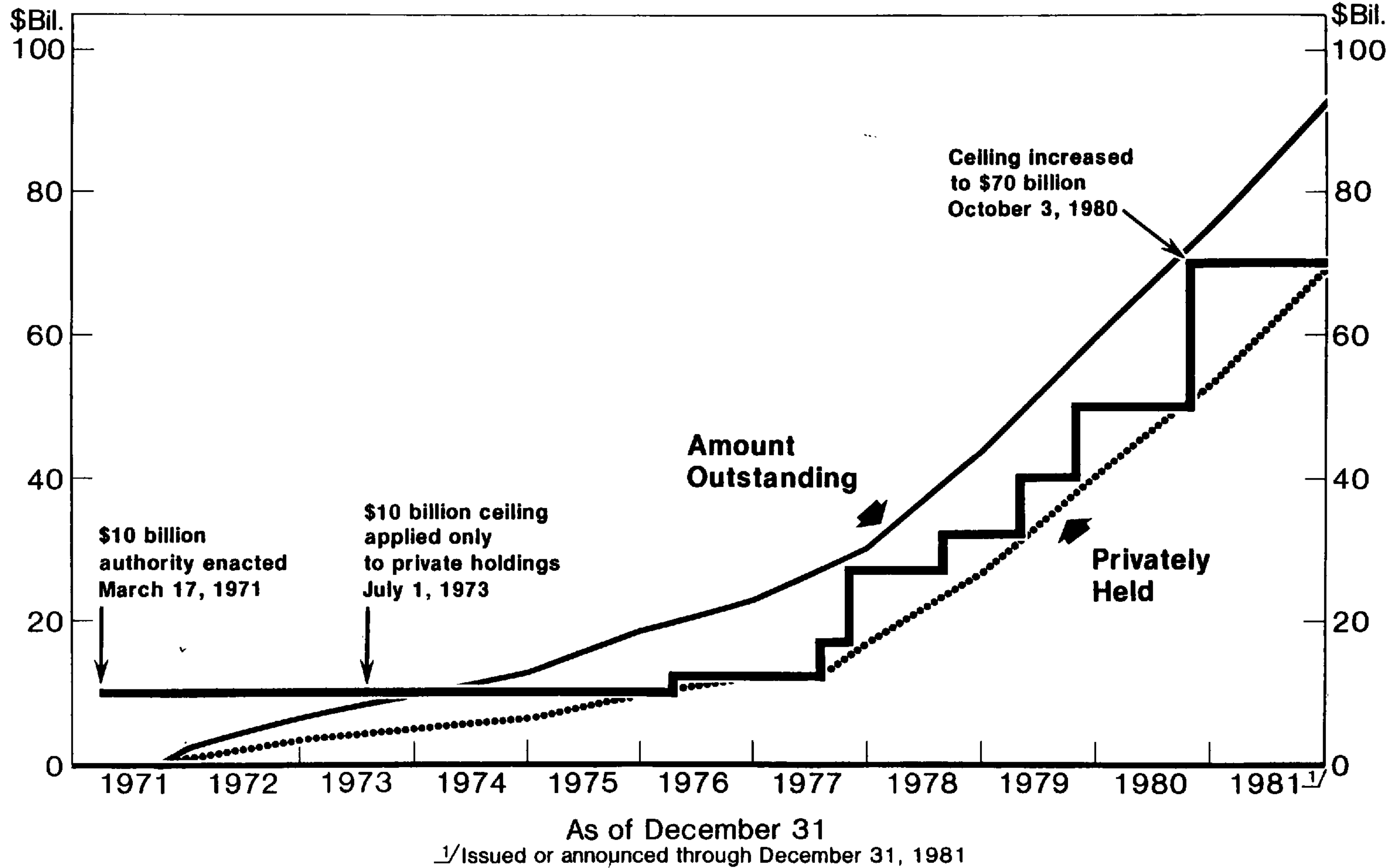
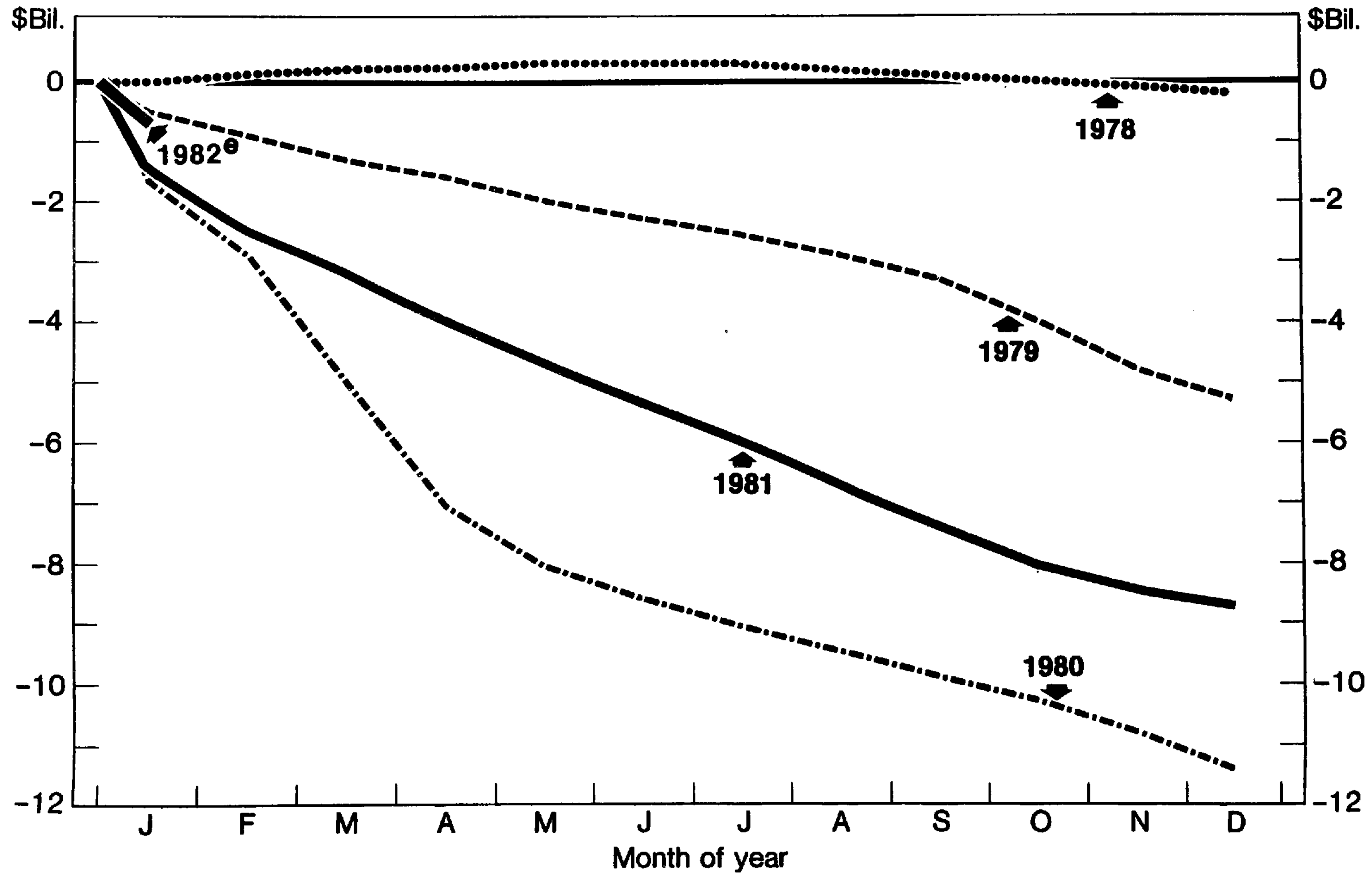


Chart 4



1/ Cash sales less redemptions
e January 1982 partly estimated

Office of the Secretary of the Treasury
Office of Government Financing

January 26, 1982-5

TREASURY NEWS

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For Release Upon Delivery
Expected at 7:30 p.m., EST

Remarks Prepared For Delivery By
The Honorable Donald T. Regan
Secretary of the Treasury
The Philadelphia Stock Exchange Dinner
The Bellevue Stratford Hotel
Philadelphia, Pennsylvania

Tuesday, March 23, 1982

"Choices"

Senator Heinz, thank you for a very kind introduction. The people of Pennsylvania are fortunate indeed to have you representing them in Washington. I might also add that the Administration has had numerous reasons to be appreciative of your presence in the Senate.

Some of you may be aware of the fact that I once ran the Merrill Lynch office in Philadelphia. That was a very happy experience for me, so I'm especially delighted to join you here tonight. In fact, the only thing I'd welcome more than an opportunity to address this group is an eight percent prime rate.

The vitality of this city is manifest in the new structure that houses the Philadelphia Stock Exchange. It's particularly fitting that the Exchange's opening be celebrated this year -- the three hundredth anniversary of the founding of Pennsylvania.

I was especially taken with the design of a trading floor that allows the public to observe the exchange in operation. I'm sure the public will be edified by the civility, protocol and decorum that prevail among the traders on the floor.

Seriously, I'm very impressed by the new building that now houses the exchange. The structure's modern design and sophisticated communications systems bespeak a forward looking, innovative and energetic financial community in Philadelphia.

Still, in the course of the transition, you've been able to preserve some of the old values and traditions. For instance, I believe that -- despite the move -- you're still within range of Bogart's and the Newstand.

And I'm glad the Exchange has stayed in the center city area, because the truest test of any broker's mettle is a daily commute down the Schuylkill Expressway. That experience is one of the few things unchanged in Philadelphia since my departure.

But much else has changed in Philadelphia and in the nation. In fact, the pace and scope of change during recent years is

enough to validate the observation by the Greek philosopher Heraclitus who said: "Nothing endures but change."

What the philosopher neglected to say was that change occurs either by chance or by choice. It's that last factor -- choice -- the truly human element in change -- that I'd like to address this evening.

One of the most significant choices by the American people was made more than a year ago with the election of Ronald Reagan. That was when the electorate said, "enough"-- enough of erratic economic policies -- enough of inflation -- enough of tax rates that penalize incentive and discourage investment -- enough of government that hinders productivity by absorbing resources from the private sector -- and enough of government that sacrifices initiative on the altar of regulation. The electorate voted for change.

In making that choice, the American people didn't merely swap one Administration for another, or place a new tenant in the White House; they demanded a new course in the affairs of the nation -- a new tack for the ship of state.

The new course we've plotted is for the long term. It's intended to produce sustained economic growth and it will. It's intended to produce jobs -- and it will. It's intended to produce lower interest rates -- and it will. These are the objectives that the Administration sought when it first devised its program for economic recovery.

That program emerged from a series of choices. We could have chosen to seek a balanced budget on the backs of the taxpayers; we chose instead to cut back the growth of government spending.

We could have allowed inflation to increase federal revenues; we chose instead to cut personal tax rates and index them.

We could have chosen the quick fix of inflating our way into prosperity; we chose instead to encourage the Federal Reserve in a policy of slow, steady growth in the money supply.

Finally, we chose to reduce regulatory intrusions into the marketplace, and we've been eminently successful in that endeavor.

The cumulative effect of all those choices is a policy that has begun to turn the economy back to the producers of this country -- to those who can generate growth, and jobs, and real wealth. And we've begun to see some of the results of that policy.

For the first time in seven years, inflation has actually declined. Some say that was an anomaly -- a transitory phenomenon. That may be partially true, but I'll wager that

there will be more of those phenomena in the months ahead -- more indicators of progress toward our goals of strong, real economic growth.

For example, for the first time in years union contract settlements are beginning to reflect -- at least in part -- the lowering of inflationary expectations. That's been manifest most recently in the automobile industry. Those settlements are portents of declining inflation.

We are rapidly approaching a new economic environment. And if we have not as yet broken the back of inflation, we at least have it pinned to the mat.

And inflation will stay pinned even during the economic recovery that is beginning to emerge. Last week, for example, the Federal Reserve announced a 1.6 percent increase in industrial production and 1.2 percent rise in capacity use.

Granted, as Aristotle said: "One swallow does not a summer make." And one or even two positive indicators does not make a recovery. Nevertheless, as spring continues, we'll see more swallows in the form of positive indicators, and we'll come into the summer with the recovery under a full head of steam.

All this of course is predicated on prompt, deliberate congressional action on President Reagan's budget. Adlai Stevenson once said: "... there are no gains without pains." This Administration made the tough choices that went into our budget proposal.

It's time for Congress to accept its portion of pain, and make the fiscal choices that will stimulate economic growth and maintain the nation's security. I believe the Administration would welcome bipartisan alternatives that don't try to balance the budget on the backs of the taxpayers, or impede our ability to defend the nation.

We understand the misgivings of members of Congress and others who are worried about budget deficits.

Let's be clear from the outset; this Administration is deeply troubled by deficits. Like taxes, deficits finance excessive government spending and absorb resources better left in the private sector. We are opposed to them as a matter of principle; and intend to see a budget in balance ultimately.

But the deficit must be put in some perspective; it can't be viewed in isolation from the rest of the economy. Granted, viewed in isolation and in terms of sheer dollars, the projected budget deficit is the largest in our history.

But that does not hold true if you put the deficit in the context of the total economy. For fiscal 1983, we're projecting

a deficit that amounts to 3.1 percent of the gross national product. The fiscal 1976 deficit amounted to 4.5 percent of the gross national product.

In fact, a number of other industrial nations during the last several years have consistently posted deficits greater than ours when compared to their gross national products. And I include among them West Germany, Japan, Italy, and the United Kingdom.

While our estimated budget deficit for 1981 amounts to two percent of our gross national product, Japan's is estimated at 3.6 percent. Indeed, Japan has in the past run a deficit as high as 5.5 percent of its gross national product.

Nevertheless, Japan's experience with inflation, interest rates and real growth stands in marked contrast to ours. The reason is primarily its stable monetary policy and high rate of saving. In 1980, for example, gross saving as a percentage of Japan's GNP was a little more than 30 percent. Our gross saving rate, on the other hand, was 18.3 percent, slightly more than half that of Japan.

Deficits must be financed, either by borrowing a portion of national savings, or by inflationary money creation. Japan has a high enough savings rate to finance a deficit with enough savings left over for investment and growth without rapid money creation. Consequently, Japan's inflation rate and interest rates have remained low.

The U.S. on the other hand has done too little saving and allowed too much money creation over time. The result has been slow growth, rapid inflation and high interest rates. We intend to change that.

Increasing the rate of saving in the United States has been one of our major objectives. We believe that goal has been achieved, and that as a result, private saving will be several times the total borrowing requirement of the federal government in fiscal 1983 and fiscal 1984.

If current and projected deficits are symptomatic of anything it is a lack of economic growth.

The only way to balance the budget, while raising living standards, is through economic growth that enlarges the tax base. We want to see growing payrolls that will contribute to federal revenues, not higher taxes on a declining number of workers and businesses.

The Congress has tried time and time again to balance the budget with tax increases. And it hasn't accomplished the objective.

Between 1974 and 1981, despite several legislated tax

reductions, overall federal tax receipts rose $338 billion; yet we still accumulated deficits of $350 billion, and today have a national debt in excess of a trillion dollars.

Raising taxes does not balance budgets. Tax increases simply give the federal government more to spend on federal programs that create constituencies for even greater spending.

Postponing the tax cuts, or eliminating them altogether would transform a tax program oriented toward work, saving, and productivity into just another attempt to fine tune the economy.

If, as Francis Bacon said, "History makes men wise," then we'd do well to learn from past attempts to attack deficits through tax increases rather than spending cuts. President Lyndon Johnson imposed a surtax of 7.5 percent in 1968, ten percent in 1969, and 2.5 percent in 1970.

And from late 1969 to late 1970, real gross national product declined one percent and unemployment almost doubled. But more to the point, the deficit -- from being marginally in balance in 1969 -- grew to $23 billion in 1971. The tax increases reduced saving, investment and gross national product, and led to a higher deficit.

If anything, that marginal balance of $3.2 billion in the 1969 budget was an exception that proved the rule: Taxes won't balance the budget, they'll simply bloat the government.

You know, I know, and every taxpayer knows that, if you send money to Washington, they'll find a way to spend it. The only way to cut government spending is to tighten the purse strings.

That's what we did when we cut tax rates. Now the free spenders in Congress are complaining about deficits. They're trying to conceal their real desires for more taxes and more spending.

That fact is plain to anyone who's paid attention to Washington during that last two decades. It's a fundamental principle that Congress will spend everything it takes in -- and then some.

Another principle of Congress is this: It is impossible to limit action on the tax code once Congress opens it up to change.

Their legislative axe will fall on much more than just the third year of the tax cut. It will very likely fall on other targets -- the cut in the tax on unearned income from seventy to fifty percent, for example, or the reduction in the long term capital gains tax to twenty percent.

I trust that no one here is naive enough to believe that Congress will eliminate or postpone personal tax relief, and

leave other aspects of the tax program untouched.

And if the maximum tax on unearned income and the twenty percent tax on long term capital gains are changed -- and they very well could be -- you can kiss much of the strength in the new issues market goodbye.

The program we have in place should stay in place.

Tampering with the tax program in the name of balancing the budget would send a clear, unmistakable message to the economy -- a message that would say, "We're back to business-as-usual -- back to the old stop and go policies.

That message will confirm the markets belief that the government -- specifically the legislative branch -- is incapable of taking the long-term actions necessary for real growth. And that belief in turn will keep interest rates high.

So now we come to the current crux of the economic problem -- high interest rates. Looked at from my vantage point, there is little reason for rates to be as high as they are.

The more I search for a reason for current interest rates, the more I'm reminded of the young Irish girl who went to Confession.

She told the kindly old curate that she was afraid she might have committed the sin of vanity.

"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 afraid. That's not a sin. It's a mistake."

Today's interest rates are no laughing matter.

After all, real interest rates have historically run three or four percent above the inflation rate. But in recent years, layered on top of real rates, have been premiums for inflation and for uncertainty.

Those premiums were understandable in the climate of inflation that existed before this Administration took office. Clearly, today there is little reason for adding a premium for inflation -- at least not at the levels that obtain today.

How much does it take to convince the markets that the government is seriously committed to slow, steady growth in the money supply, to not monetizing the debt, and to restoring the economy to a non-inflationary course?

Think about this for a moment; Federal borrowing this year

will take about twenty-two percent of the funds in the credit market.

In 1975, the government preempted fourty-two percent of the credit available and interest rates were declining.

In light of this year's relatively minor pressure on the credit markets, one can only conclude that real interest rates of seven or eight percent -- if not unconscionable -- are at least paradoxical.

I'm sure that in time that paradox will be resolved as we move toward a growing economy -- one without the torments of inflation -- one that affords every one the prospect of prosperity.

In the final analysis problems of economic policy are human problems. Behind the cold numbers issued by the Bureau of Labor Statistics are people and families who ask only the opportunity to put their skills to work in some productive endeavor.

We understand that human dimension, and we're fully prepared to put our policy where our principles are. This morning the President announced that he would send legislation to Congress creating enterprise zones that will promote economic growth in depressed areas.

It's a strategy that we believe will revitalize many of the depressed areas in this country -- particularly in the inner cities.

We believe that reducing the burdens of taxation and federal regulation will create a hospitable economic atmosphere in these zones -- one that encourages new businesses and preserves existing businesses.

A combination of tax incentives will be provided for employers: among them are a five percent investment tax credit for capital investments in personal property, and a tax credit for wages paid to employees who were considered disadvantaged when hired.

The program also contains incentives for people who choose work over welfare; it's a five percent tax credit to employees working in the Enterprise Zone.

A host of other incentives is built into the legislation. We estimate that the package, as proposed, will allow the creation of as many as twenty-five Enterprise Zones.

This program represents more than mere abstract care for the poor and disadvantaged. Our concern is real, active, and in a sense personal. President Reagan, myself and most of the cabinet are old enough to remember the lean years. Our generation has

been marked by that experience, just as a later generation was marked by the experience of the war in Vietnam. And to paraphrase George Santayana: Remembering our past, we will not be condemned to repeat it.

Rather than repeating the past -- either the past of the thirties, or the recent past of inflation and periodic slumps -- we instead look to a future that will be different.

In that future we see a vibrant, secure, productive nation. And we see it beginning this year.

Thank you.

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Contact: Marlin Fitzwater
566-5252

Remarks by
Donald T. Regan
Secretary of the Treasury
Bucknell University
Lewisburg, Pennsylvania
March 22, 1982

"Morality and Capitalism"

I am delighted to be at Bucknell University today to talk with tomorrow's entrepreneurs about capitalism and the values that make it work. You know, one of the elements essential to the character of an entrepreneur is faith -- which is why I know I'm preaching to the choir here at Bucknell. You see, I know there's no doubt in your minds that the next time you meet Lehigh in a football game you're going to win ...

Perhaps I shouldn't have taken such liberty, however, in assuming any of you expect or want to become entrepreneurs. The highbred and highbrows of this world have often looked askance at those "in trade." The very name "capitalist" was dreamed up by intellectuals in the middle 1800's as an insult. You know the way it went: capitalists are a useful sort, but you wouldn't want your daughter to marry one ...

Unfortunately, too many Americans really do feel that capitalism is not very noble, that somehow our economic system is something to apologize for. Today I hope to rid you of any such misplaced feelings of guilt. I believe capitalism proves its morality in two ways: first, those character traits engendered in the people who practice it and second, the effect it has had in raising the standard of living for all mankind. The theory of capitalism may be prosaic, but its effects make it the most moral any people have ever tried.

Well, I stand before you a capitalist, and proud to be one. Not just a consumer, I am part of this country's phenomenal process of production. I have been contributing to the growth of our society -- increasing its well-being, not just spending its benefits. I believe capitalism to be an honorable way of life and one that encourages man's better nature.

Don't get me wrong. I have no intention of defending big business or corporate America. Those impersonal institutions no longer belong to individuals -- much of their stock is held by groups -- so they feel less strongly the constraints of individual values, needs and morality. Belonging to no one in particular and responsible only to the bottom line, too many have become more like government bureaucracies than cradles of

risk-taking and entrepreneurial spirit.

What I do defend is commerce.

It may be dull, and rarely heroić, but a nation of small merchants is a nation whose people hold close those practical virtues known as "bourgeois" values. Democratic capitalism encourages thrift, discipline, hard word, public-spiritedness and, yes, honesty. It rewards individual effort, which is why it is no accident that capitalist countries in the world are outproducing socialist ones by nearly 2 to 1.

But I don't think capitalism's intellectual critics find a lack of morality in our system, I think they just find its code of ethics, the values it encourages, to be, well, boring. Commercial societies tend to produce a citizenry that is non-self-righteous, non-ideological, moderate, and willing to split the difference. It must seem terribly unromantic to those who yearn for righteous purity, but it kept society from the frequent divisive strife endemic to so many other lands.

Americans have been called every name in the book -- materialistic, narcissistic, selfish, mean-spirited and petty. After all, their entire way of life is based on self-interest. But a funny thing happens to the theory on its way to reality. Somewhere along the line we all realize that we can't calculate our self-interest properly without having a respect for others.

The merchant who cheats his customers, the salesman who belittles his clients, the businessman who gouges his buyers will soon be looking for other ways to make a living. We learn, in our free commercial dealings, to be sensitive to the desires of others, tolerant of their differences, understanding of their wants and even neighborly to our fellow citizens.

The theory of capitalist selfishness is forever belied by the truth of the reality. We are, in fact, a nation of volunteers, of charitable organizations, of magnanimity and of friends.

As a matter of fact, it has recently been estimated that about 52 percent of adult Americans -- 84 million of us -- work in our spare time at some worthy cause, or contribute to it. That's the kind of people our system produces, and that's the kind of character that keeps us strong.

But, in truth, I have stepped out of my capitalist role temporarily. I went to Washington at President Reagan's request because I feel, as he does, that this country is drifting dangerously far from that well-charted course first laid out for us by our Founding Fathers. Past leadership in Washington has falsely led too many of our people to believe that somehow our system of democratic capitalism caused our economic problems at home and around the world. We've been told that our appetites

have ravaged underdeveloped nations -- robbing and plundering their resources.

Well, let's just take a look at what capitalism has done to the world. A book Michael Novak is soon to publish -- The Spirit of Democratic Capitalism -- lays it our pretty clearly. Until the United States came into being in 1776, the classical pattern of political economy was mercantilist. Famines ravaged the civilized world on the average of once a generation. Plagues seized scores of thousands. In the 1780's four out of five French families devoted 90 percent of their incomes simply to buying bread -- only bread -- to stay alive. Life expectancy in France was about 27 years for women and 23 for men.

At the beginning of the 19th century, travelers from Europe, accustomed to poverty at home, were appalled by the still more unspeakable conditions they found in Africa and Asia. In most places, elementary hygiene seemed unknown. In Africa, the wheel had never been invented. Most of the planet was unmapped. Hardly any of the world's cities had plumbing systems. Potable water was mostly unavailable, and ignorance was so extreme that most humans did not know that unclean water spreads disease.

But the American revolution exploded onto the scene at almost the same time as Adam Smith's The Wealth of Nations. The world would never be the same. In reality the American way of life, enterprise in liberty, is the world's only hope.

There should be no doubt that our Founding Fathers fully intended this land to be one of commerce, encouraging creativity, risk-taking, investment and moral responsibility. By the year 1800 there were more private business corporations in the infant United States than in all of Europe combined.

It's been said that it's hard to write a poem about moneymaking or sing an inspiring song about the marketplace. The theoretical equality of socialism seems much more attractive and noble. But all we have to do is look around us to see the proof that America has been the glory of modern times.

We capitalists have brought light where before there was darkness, heat where once there was only cold, medicines where there was sickness and disease, food where there was scarcity, and wealth where humanity was living in squalor.

In Novak's words, "After five millennia of blundering, human beings finally figured out how wealth may be produced in a sustained, systematic way."

We must look beyond the theory to find the morality of capitalism, but we needn't look too far. We have only to see its effects to realize that democratic capitalism has lifted the standard of living for more people in more places in a shorter period of time than any other system in the history of mankind.

It is a system that requires the apology of no American.

But if you scratch the surface of even its theory, if you look closely at what makes capitalism work, you will also find, as Irving Kristol writes, its moorings in morality.

Alexander Hamilton, the first Secretary of Treasury, made clear that the maintenance of good credit, the paying of public debts, was essential for both the Nation and its citizens. He said "good faith" was key to our success, explaining, "States, like individuals, who observe their engagements, are respected and trusted: while the reverse is the fate of those, who pursue an opposite conduct." He cited "moral obligation," and said, "in the order of Providence" there is a connection "between public virtue and public happiness."

What has become known as the Puritan ethic was the foundation of America's political and economic system. Our Founding Fathers did not equate self-interest with taking advantage of others. They designed a political and economic system to be run by a people under God and trusting in God, working His will in their daily lives.

As a matter of fact, the <u>only</u> way capitalism can work is when it is <u>tied</u> to morality, when equity, fairness and compassion are the hallmarks of its people, and when the limited government that oversees the system is ready and able to help those who cannot help themselves.

The philosophy of capitalism that I have just gone through is also at the heart of this Administration's economic policy. The same key elements -- the natural, human drive to make a better life; the risk-taking and the faith in the entrepreneurial spirit -- are also the keys to the President's program for economic recovery.

President Reagan believes, as I do, that big government has been booming out of control in the last few decades while our economy has limped from one recession to another. We don't believe the system has suddenly failed us, that it has outlived its usefulness, or that it is too simple for today's complex world. We believe that some of our leaders have failed the system.

As the tax burden has escalated -- increasing more than 200 percent in the last ten years -- and as social spending has mushroomed -- Government outlays in the same period went up by 300 percent -- the values of work and family were slowly being eroded.

In the last 15 years, the cost of our food stamp program has gone up more than 16,000 percent. In just 10 years Medicaid and Medicare have increased by more than 500 percent. At the same time inflation and interest rates were soaring, unemployment was

climbing and the misery index for Americans hit an all-time high.

There is no question that we in this country have a solemn obligation to take care of our needy, to feed those who are hungry and shelter those who are cold. Our elderly must be allowed to live out their lives in security and dignity.

We do not propose to abandon those values nor undo that style of compassionate life known as the American Way. Far from it, we are desperately trying to save it.

On behalf of the young couple who dreams of buying their own home, we are struggling to wring out inflation and bring these intolerable interest rates down. On behalf of those who have no jobs, we have proposed programs that will provide them work. We have created new incentives for small business and for industry, incentives that will result in new jobs and new opportunities. On behalf of our elderly, our handicapped and our disadvantaged we have reaffirmed our commitment and redoubled our efforts to protect them from the inflation that has been ravaging their pensions. On behalf of all Americans, we are returning our government and our economy to the people.

After too many decades of more and more spending and more and more taxing, our program for economic recovery returns sane fiscal policy to Washington. The joke is that if you laid all the economists in Washington end to end they'd never reach a conclusion, but the truth is that the economic advisors in Washington have consistently believed that all our problems would go away if only we would spend more. So our leaders taxed more and then spent even more than that.

This Administration has no intention of turning its back on Americans in need of help, but when these programs have been growing with wanton disregard for so many years, why does a proposal to cut their rate of growth send so many people on Capitol Hill up in arms?

At a time when automobile workers are suggesting their own pay cuts just to keep their jobs, this Administration has no intention of succumbing to the spending addiction so rampant in the Congress. At a time when salary increases are no longer just falling behind but the wages themselves are being cut, well, the Administration believes big government should tighten its belt, as well.

An all-intrusive Federal Government never has worked and it never will, and it is time some people in Washington realized the rest of the country is tired of it.

Let me be very clear that we in the Reagan Administration wholeheartedly believe that economic sanity includes balancing the Federal budget. I wouldn't mind if balancing the budget every year became a requirement of the Constitution. But I don't

think the way to do it is by making that auto worker's check even smaller. We refuse to balance the budget on the back of the already weary American taxpayer.

You see, we believe in the American system. We appreciate what the incentives and motivations of capitalism have done for this country and the world. We propose to unleash them again. We intend to put the entrepreneurial spirit back in the center of our economy so once again it can be the wellspring of progress and the promise of a better life for all our people.

Our programs have only begun to take effect, but surprise! Look what has happened in only half a year! Changes in the capital gains tax have spurred investor interest in new companies, with more than 400 going public last year. In that sense, 1981 was a record year for the risk-taker, the investor and the entrepreneur. That means more competition, more progress and a better deal for the consumer.

Such a program, it is true, offers no quick fixes, no instant gratification. But it is fair, and it is compassionate.

Let me also set the record straight. Although we were able to pass, last year, the largest budget cuts in history, these cuts only slowed the rapid increase in government spending. And although our 3-year, across-the-board, 25 percent tax rate reduction is the largest tax cut working Americans have ever experienced, it also only offsets the incredible increase already scheduled in our taxes.

If you understand the rate at which government programs are growing -- a rate which by far outdistances the salaries of the working Americans who must pay for them -- you get a better perspective on the cuts we propose. We have never suggested spending less in next year's budget than in the year before. We only want to reduce the increase!

Let me give you a few examples of the level of human services we are still providing in the 1983 budget:

-- Nearly 7 million separate loans or awards will be made available for students in higher education through Federal assistance programs. Since the college-level population numbers only slightly more than 11 million, that means better than one out of every two students has the opportunity for assistance. Although reduced from last year by about $1.5 billion, the 1983 budget provides more than $12 billion in total tuition support, nearly three times the level available in 1977.

-- The Federal Government will subsidize approximately 95 million meals per day, or 14 percent of all meals served in the United States.

-- Through Medicaid and Medicare, the Federal Government

will pay for the medical care of 99 percent of those Americans over the age of 65: approximately 47 million aged, disabled and needy people, 20 percent of our population.

-- Twenty-eight percent of all Federal spending will go to the elderly -- an average of $7,850 per senior citizen in payments and services.

-- About $2.8 billion will be spent on training and employment programs for almost 1 million low-income people, nearly 90 percent of whom will be below the age of 25 or recipients of Aid to Families with Dependent Children.

-- About 3.4 million American households will receive subsidized housing assistance at the beginning of 1983. By the end of 1985, under Reagan Administration proposals, 400,000 more households will be added to the list.

-- And just today, President Reagan sent to the Hill legislation for a new effort to revive the decaying areas of America's inner cities and rural towns. The "Enterprise Zone Tax Act" is an experimental, free market program for dealing with the severe problems of our Nation's economically depressed areas.

I think these examples clearly demonstrate that we in this Admnistration are not turning our backs on America's needy. The safety net is still there.

But our program to cut spending, cut taxes, cut regulations -- to rely again on the magic of the marketplace -- also offers our people their only hope of avoiding the scarcity and misery found in so much of the rest of the world.

One need only look around the globe for proof that increasing government control, further punishing our producers and robbing everyone of incentive -- in short socializing our economy -- will not work. In Russia, the average worker produces only half the goods and services of his American counterpart. His economy has been described as one of "scarcity underlined by long lines at stores, black marketeering, bribe giving and bribe taking." Already grim, his living standards are expected to decline even more. Economic growth rates are sliding to near zero levels.

A Czechoslovak economist admits publicly that, "It is becoming clear that for a full 30 years we have been unable to solve problems associated with production under socialism, either in theory or in practice." As a news magazine recently reported, for the 1.5 billion inhabitants of the Communist world, the Marxist promise of a worker's paradise has turned into a nightmare of permanent scarcity, economic stagnation and discontent.

In Poland such economic discontent was put down with

Orwellian tactics. Phones were cut off. Travel was forbidden. You couldn't send or receive telegrams. Mail was restricted, opened and censored. Malcontents were rounded up and imprisoned. Newspapers were closed down and television was taken over by the army.

It was not long after that military crackdown in Poland that Susan Sontag, the very model of a left-liberal intellectual who had once visited Hanoi, spoke through the jeers of her colleagues to revise her assessment of communism.

"There are many lessons to be learned from the Polish events," she said, "but I would maintain, the principle lesson ... is the ... failure of communism, the utter villainy of the communist system. It has been a hard lesson to learn. And I am struck by how long it has taken us to learn it."

I only hope we have.

Our system of democratic capitalism, based on the freedom and genius of the individual, with individual rights and responsibilities under representative government and the rule of law, was a unique and precious gift to the world. It has been handed carefully to us by our forefathers, and it is ours to protect and nurture for the generations that are to follow.

My message to America's youth, as they rise to take their places in American business, government and society, is to care for it well.

Abraham Lincoln once said that we Americans, the freest people in the world, will determine our own fate. If it is to be greatness, we will have built it; if it is to be destruction, then we will have wrought it. "As a Nation of freemen," he said, "we must live through all time or die by suicide."

When you leave Bucknell that responsibility will become yours. America needs the dreams of its youth. We need their ideals and their passion for equity, justice and fairness. Our country needs its best minds and all our energies as much now as in any crisis in our history. There can be no new wealth unless we create it, no new discoveries unless we find them. And we will neither create nor discover until we once again are willing to gamble that we have it within ourselves to shape a better tomorrow -- to bring progress and prosperity to our country and the world.

Join us in our crusade to breathe new life into our system of enterprise in liberty. Restore with us the values that make it work. Together let us be sure that future generations never say freedom was lost between us.

Thank you very much.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. March 23, 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 $9,400 million, to be issued April 1, 1982. This offering will result in a paydown for the Treasury of about $ 50 million, as the maturing bills are outstanding in the amount of $9,444 million, including $2,043 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,426 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 $ 4,700 million, representing an additional amount of bills dated December 31, 1981, and to mature July 1, 1982 (CUSIP No. 912794 AV 6), currently outstanding in the amount of $4,922 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 4,700 million, to be dated April 1, 1982, and to mature September 30, 1982 (CUSIP No. 912794 BN 3).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing April 1, 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, March 29, 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 three decimals, e.g., 97.920. 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.

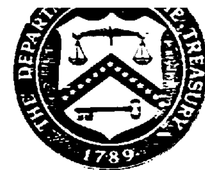
Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in 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 April 1, 1982, in cash or other immediately-available funds or in Treasury bills maturing April 1, 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 566-204

FOR IMMEDIATE RELEASE
March 23, 1982

CONTACT: Robert Don Levine
(202) 566-2041

No Change in the Sale of Treasury Securities

The Department of the Treasury announced today that it has completed its review of procedures for small investor participation in Treasury security auctions and has decided not to change its procedures at this time. It will continue to sell Treasury bills, notes and bonds as it has in the past at the main Treasury building in Washington and at Federal Reserve Banks and branches across the country. There will be no change in the minimum tender and no charge for this service.

R-693

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. March 23, 1982

TREASURY TO AUCTION $3,250 MILLION OF 7-YEAR NOTES
TREASURY CANCELS 20-YEAR BOND

The Department of the Treasury will auction $3,250 million of 7-year notes to raise new cash. Additional amounts of the notes may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

Treasury has exhausted its $70 billion authority to issue long bonds with coupons in excess of 4-1/4%. Due to Congressional inaction to expand Treasury's authority to issue long bonds, the 20-year bond normally announced at this time will not be sold.

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

Attachment

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R-694

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 7-YEAR NOTES
TO BE ISSUED APRIL 7, 1982

March 23, 1982

Amount Offered:

To the public	$3,250 million

Description of Security:

Term and type of security	7-year notes
Series and CUSIP designation	Series D-1989 (CUSIP No. 912827 NB 4)
Maturity date	April 15, 1989
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	October 15 and April 15 (first payment on October 15, 1982)
Minimum denomination available	$1,000

Terms of Sale:

Method of sale	Yield auction
Accrued interest payable by investor	None
Preferred allotment	Noncompetitive bid for $1,000,000 or less
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, March 31, 1982, by 1:30 p.m., EST
Settlement date (final payment due from institutions)	
a) cash or Federal funds	Wednesday, April 7, 1982
b) readily collectible check	Monday, April 5, 1982
Delivery date for coupon securities	Monday, April 19, 1982

TREASURY NEWS

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

STATEMENT OF
MARGERY WAXMAN
DEPUTY GENERAL COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ON MARCH 25, 1982
CONCERNING PROPOSED LEGISLATION TO EXTEND THE
INSPECTOR GENERAL ACT OF 1978
TO THE TREASURY DEPARTMENT

Mr. Chairman, I am pleased to have the opportunity to appear before this Committee and to provide the views of Treasury concerning the proposed amendments to the Inspector General Act of 1978. Accompanying me is the Department's Inspector General, Paul Trause.

As the Assistant Secretary for Administration stated in her testimony before this Committee on April 8, 1981, the Treasury Department supports the establishment of a statutory Inspector General and agrees with the general thrust of this bill. In fact, we have had an administratively created Office of Inspector General since July 1978, and we are proud of the way that Office has functioned.

During fiscal year '81 the Department's internal auditors produced over a half billion dollars in audit penalties, recoveries and additional revenues; $2 million in questioned costs disallowed through audits and approximately $9.7 million in possible savings through new procedures. Further, the Department's internal investigators completed about 8500 investigations. These investigations resulted in over 210 prosecutions and over 1900 administrative disciplinary actions. The investigations also produced over $8.8 million in penalties, recoveries and additional revenues.

These accomplishments and the future of the Inspector General's office must be viewed in light of Treasury's mission. Unlike most Departments with statutory Inspectors General, the Treasury Department, with the exception of the revenue sharing program, administers neither grant nor entitlement programs. Further, Treasury does not engage in extensive contracting. Rather, Treasury's responsibilities

are in economic, tax, and monetary policy, tax administration, and law enforcement. It also receives and disburses the Government's funds. Thus, Treasury's audits and investigations have focused on the adequacy of the Department's internal control procedures. Their goal has been to protect the integrity of the Department's systems and to ensure that the monies handled by the Treasury are processed expeditiously and safely.

The proposed legislation recognizes the unique nature of the Treasury by protecting the Department's mandate to help establish the nation's economic policies and its law enforcement priorities while ensuring the independence of the Inspector General.

Because of the nature of Treasury's mission, the sensitivity of its activities, and its role in formulating economic and monetary policy, we have maintained that the internal audit and investigation functions must be kept separate from the unique policy functions of the Department. Section 8C(c) of the proposed amendments to the Act would ensure this separation.

The need for separating policy and audit functions can be seen most clearly as you begin to examine Treasury's various economic and law enforcement functions. For example, Treasury has offices which are involved in such areas as trade and investment policy, bank regulation, loan guarantees, international and domestic tax policy, foreign assets control and multilateral development banks. Decisions made by Treasury officials with respect to these activities are made in the context of broad economic and public policy considerations, both domestic and international. Empowering an Inspector General to review these policy decisions could not only affect Treasury, but the nation's economic and foreign policy as well. Second-guessing economic policy decisions through the Inspector General's Office could have a significant unintended effect on the financial markets whose performance often reflects these policy decisions. This is particularly true because the Inspector General would be obligated by the Inspector General Act to make public semi-annual reports which would contain recommendations for corrective action in the Department's programs and operations.

The same argument holds true in the area of law enforcement. For example, a decision made by officials of the Customs Service to commit vast resources and staff power to a

lengthy drug smuggling investigation might be viewed by an Inspector General as inefficient or ineffective. But law enforcement activities are not meant to be measured solely in terms of cost effectiveness or from the Inspector General's perspective. Program officials with direct responsibility and expertise must exercise their professional judgment in these unique areas without the harmful effects of second-guessing by the Inspector General.

Finally, to the extent that an Inspector General makes specific recommendations as to the wisdom of policy objectives of a particular program, he or she acquires a stake in the perceived effectiveness of these objectives. If the organization accepts the recommendations, the Inspector General is not then in a position to be as objective in assessing the achievement of its goals.

The proposed legislation, however, does not limit the Inspector General's authority to review allegations that a decision was improperly influenced, or that funds, once allocated, were not properly expended or administered. This function traditionally has been at the heart of the Inspector General's role and, as the figures which I cited show, can be and has been performed effectively by the Treasury's Inspector General. Because this bill will protect the Inspector General's independence and enhance his ability to act aggressively against fraud, waste and abuse without impeding the Department's key policy-making functions, the Department, as previously stated, agrees with the establishment of a statutory Inspector General.

We believe, however, that two changes should be made in the bill. First, the program review function and the related resources in the Customs Service, the Bureau of Alcohol, Tobacco and Firearms and the Secret Service should not be transferred to the Inspector General's Office. These units have functioned as in-house management consultants rather than as true internal auditors or investigators. They are essential to line management's ability to diagnose and to address problems before they become major crises. If managers are deprived of these resources, they simply will be forced to divert other resources to meet their legitimate management needs. Therefore, transferring these resources to the Inspector General's office will result in unnecessary duplication and will not add materially to the Inspector General's ability to combat waste, fraud and abuse.

Second, Treasury does not believe that the Inspector General should be authorized to release information about an on-going criminal investigation. The Department has adopted a consistent policy that this type of information should not be released and does not believe that the Inspector General should be exempted from this important policy. The official release of information about which there has been public speculation obviously could harm on-going investigations.

This concludes my remarks on the proposed legislation. Thank you, I will now be pleased to answer any questions that you may have.

TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
Expected at 11:30 a.m.
March 24, 1982

Testimony of the Honorable Roger W. Mehle, Jr.
Assistant Secretary of the Treasury
(Domestic Finance)
Before the
Subcommittee on Housing and Community Development
of the
House Committee on Banking, Finance and Urban Affairs

Mr. Chairman and members of this distinguished Subcommittee:

I appreciate this opportunity to review with you again the condition of depository institutions, their ability to deliver credit to all sectors of the economy and the contingency plans available to deal with any problems confronting the institutions. In particular, Mr. Chairman, I am pleased to present the Administration's testimony on H.R. 5568, the "Home Mortgage Capital Stability Act" introduced by Chairman St Germain.

My testimony today will focus on the current condition of thrift institutions, how we should be structuring and modernizing legislative and regulatory constraints that affect them, and the role for measures like those suggested in Chairman St Germain's proposed legislation. Every action we take should be part of a process of building a strong and competitive framework that will give our thrift institutions the flexibility to respond to a changing financial environment and shifting market forces for years to come.

Condition of Thrift Institutions

Despite enormous inflationary pressures, our depository institutions generally have been performing adequately. The foreign and domestic assets of Federally insured commercial banks increased 9.1% in 1981 and their return on equity,

after tax, was a healthy 13.2%, compared with 13.7% in 1980. Bank net worth increased 9.3%. Federal credit unions increased their assets by 6.4% in 1981 and achieved a rate of return on assets of .57% in 1981 which is a three fold increase over their .14% rate of return in 1980.

The one problem area involves thrift institutions (savings and loan associations and mutual savings banks). The assets of Federally insured savings and loan associations and mutual savings banks increased 5.2% and 2.4%, respectively, in 1981. However, as a result of operating losses experienced by both types of institutions, their net worth declined 15.0% and 12.3%, respectively. There should be no doubt that the Administration is very much aware of the thrift industry's earnings, and hence, its net worth problems. We are concerned both for the health of the industry itself and for the flow of funds to the housing sector.

As we discussed during my appearance before the full Committee last July, the fundamental problem facing thrift institutions is the structural imbalance between an asset portfolio dominated by long-term, fixed rate, low-yield mortgage instruments and liabilities increasingly dominated by rate-sensitive shorter-term deposit instruments.

Thrift institutions are using an increasing amount of deposit liabilities with interest rates that vary with market rates to make new mortgage loans or to carry long-term mortgages made in prior years at fixed rates of interest. The institutions' deposits which are under Federal interest rate ceilings are inevitably eroding as customers take advantage of alternative market rate accounts both within and outside the institutions.

This imbalance between increasingly rate sensitive liabilities and long-term rate insensitive assets is central to the thrift industry's earnings problems. For almost two years, short-term interest rates have exceeded the rates on most of the institutions' existing mortgages. As a result, thrift institutions have been paying more for their liabilities than they are earning on their assets, thus operating at a loss and eroding their net worth.

Declining Net Worth; Adequacy of Cash Flow

Until short-term interest rates decline, and the average cost of funds falls below the average asset portfolio yield, thrift institutions will continue to experience operating losses eroding their net worth. The decline in net worth is important not for its own sake, since it does not determine

a depository institution's ability to conduct its business, but because at some point depositors and lenders may become troubled by the erosion of an account commonly (and correctly) thought of as a mark of financial soundness for non-depository institutions.

In addition, some state regulatory officials and others concerned with the industry's condition have come to accept net worth declines below some arbitrary minimum level as automatically necessitating a merger or liquidation of the institution in question. In at least one state a thrift institution may not pay interest on deposits if its net worth falls below a specified percentage of deposits. This is true despite the fact, as I said, that a decline in net worth does not necessarily inhibit the institution's day-to-day operations so long as the institution can maintain a positive cash flow.

In contrast to its poor earnings performance for the past two years, the thrift industry has had, and continues to have, ample cash flow with which to conduct its business and meet its obligations to depositors. Interest income, mortgage principal repayments and Federal Home Loan Bank borrowings have more than offset withdrawals of thrift industry deposits during the last twelve months. Such excess funds have been invested in new, higher yielding assets, principally mortgage loans, and have resulted in an increase in savings and loan assets by 5.6% between the end of January 1981 and the end of January 1982.

Interest Rate Deregulation

What the industry needs most immediately, along with the entire economy, is lower short-term interest rates. But for a long-term solution to the industry's problems, we must also deal with the asset and liability structure that limits the ability of thrifts to cope with high interest rates.

During the twelve months ended January 31, 1982 only deposit categories paying market and near market rates of interest have generated additional deposit flows. Such accounts at savings and loan associations increased by $70.2 billion, or 24.6%, between January 1981 and January 1982, while those accounts paying less declined in the aggregate by $55.6 billion, also 24.6%. In particular, the 2-1/2 year small saver certificate alone provided an additional $40 billion -- an increase of 66% in 6 months -- after the Depository Institutions Deregulation Committee (DIDC) removed the 12% interest rate cap last August and let the rate float with the 2-1/2 year Treasury note yield.

To assure all depository institutions' ability to continue to obtain deposit resources, the DIDC has acted to raise strangulating interest rate ceilings and create new deposit account categories competitive with open market alternatives, particularly money market funds. On Monday, March 22, the DIDC created a three-month time deposit indexed to 91-day Treasury bill rates with a quarter of a percentage point interest rate differential in favor of thrift institutions. In addition, the Committee acted to begin phasing out interest rate ceilings on time deposits starting with maturities of 3-1/2 years and over. Deregulation at the longer end of the maturity structure of regulated deposit accounts will enable all depository institutions to attract a more stable base of longer-term funds.

Structural Thrift Industry Problems

Apart from the necessity for competitive deposit accounts, let us focus on the basic structural problems of the thrift industry. As I stressed in my July testimony before the full Committee, thrift institutions must have the ability to invest in a portfolio of assets which will provide greater rate sensitivity and allow a sufficient rate of return during all phases of the business cycle. The long-time limitations imposed upon them to invest nearly exclusively in fixed rate mortgages is largely responsible for their present plight.

Legislation has been introduced in both the House and the Senate to accomplish an important first step in removing governmental restrictions on the thrift industry. The relevant bills are the "Thrift Institutions Restructuring Act of 1981," H.R. 4724, introduced by Congressman Stanton, and S. 1720, the "Financial Institutions Restructuring and Services Act of 1981." Congressman Stanton's bill and the comparable provisions of S. 1720 have the Administration's strong support, with few exceptions, and I urge the House Banking Committee to take prompt action on H.R. 4724.

I will now review the most significant features of the legislation in the Administration's view and set forth our reasons for supporting them.

Expanded Asset Powers

Title II of the Stanton bill would give thrift institutions many of the same investment and lending powers that commercial banks now have, such as the power to make commercial and agricultural loans, with only such limitations as are applicable to a national bank of the same size. The bill's

approach is appropriate, since our goal is to permit all depository institutions eventually to compete on equal terms. We recognize that this legislation would not eliminate all inequalities between thrift institutions and commercial banks, but it would move us a long way in that direction. It is important that we make as much progress as possible in deregulating thrift institutions at this time; we can deal with remaining inequalities at a later date in other legislation.

Providing thrift institutions with new investment and lending powers need not diminish their contribution to housing finance, however. Real estate lending is their area of greatest expertise and they are likely to continue expanding this activity. The ability to make a broader range of loans and investments should supplement their real estate lending and help the industry stabilize its earnings in periods when there is strong demand for other services, such as commercial and consumer loans, but a relatively lower demand for mortgages.

Interstate and Interindustry Mergers

Both H.R. 4724 and S. 1720 would authorize emergency interstate and interindustry mergers and acquisitions to rescue troubled commercial banks and thrift institutions. The flexibility so granted would greatly assist the regulatory agencies in coping with problem organizations. It should also reduce the cost to the Federal deposit insurance agencies by opening attractive markets to acquirers who might pay a premium for a troubled institution in order to enter one of those markets. We regard provisions for interstate and interindustry mergers and acquisitions as an essential element of any legislative assistance to the thrift industry.

Preemption of Due-on-Sale Clause Prohibitions

The Administration has reviewed provisions of H.R. 4724 and S. 1720 which would preempt state due-on-sale clause prohibitions and has determined that preemption is necessary and appropriate. We would confine the preemption to Federally chartered depository institutions, as well as lenders -- other than state chartered depository institutions -- approved by the Secetary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act. State-chartered depository institutions have the ability to convert to a Federal charter if state due-on-sale prohibitions prove onerous or if the states do not eliminate such prohibitions.

Preemption of State Usury Ceilings

The Depository Institutions Deregulation and Monetary Control Act of 1980 preempts state usury ceilings on mortgage and commercial loans, if state legislatures do not reinstate the ceiling for their states within three years from the effective date of the Act. We favor provisions of S. 1720 which would preempt usury ceilings for all loans in the manner prescribed in the Deregulation Act. In our opinion, usury ceilings can only distort financial markets and credit flows and do not reduce the cost of credit in the economy. Moreover, if usury ceilings on consumer loans are not preempted thrift institutions will be discouraged from developing their new consumer loan powers.

Now, Mr. Chairman, let me turn to the short term problems of thrift institutions.

Public Confidence in Depository Institutions

One of the principal advantages of a Federally insured depository institution is that it can offer accounts insured by an agency of the Federal government for the first $100,000 of a customer's total deposits4 Although we believe that there is, no reason to question the ability of the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) to meet their insurance obligations, a variety of commentators has expressed concern about whether the insurance agencies would be able to handle the problems of the thrift industry arising from their losses and consequent net worth decline.

As a result, several actions have been taken to eliminate those concerns. First, senior Administration officials have stated publicly that the United States Government will do whatever might be necessary to aid the insurance agencies in their protection of depositors. The Secretary of the Treasury made this point specifically on Monday in an opening statement at the quarterly DIDC meeting. Second, Congressional resolutions have been passed by both the House and Senate which make clear Congress' position in this regard. We are not assuming the insurance agencies' liabilities and their responsibilities, but we are committing to assist them in the unlikely event that they need assistance.

At the present time, the Treasury line of credit to the FDIC fund is $3 billion and to the FSLIC fund is $750 million. There seems to be little question as to the adequacy of the FDIC line of credit, and the Administration cannot now foresee that even the FSLIC will have any need to draw on its line

of credit. Even after merger assistance, the FSLIC insurance fund balance at the end of 1981 was $6.3 billion, as compared to $6.5 billion at the end of 1980. The fund appears to be adequate for presently projected needs and certainly any likely rate of utilization will be slow enough to permit due reconsideration by Congress and the Administration of any need to expand the backup line.

Income Capital Certificate Program

To the extent that specific assistance is required to alleviate temporary net worth problems for those members of the industry that otherwise are viable, we believe that Federal agencies have the authority and means to furnish such assistance under current law. We believe the recently developed FSLIC Income Capital Certificate (ICC) program shows that adequate relief can be provided. The ICC is a security issued by savings and loan associations to the FSLIC in exchange for an FSLIC note, which provides the issuing association with net worth. These FSLIC notes do not require the use of cash except for interest payments, and therefore have only a limited Federal budget impact. There would be an additional budget expenditure only if the notes were required to be paid off in cash to an institution, which, given the adequacy of the industry's cash flow, is extremely unlikely.

Already the FSLIC has used ICCs on four occasions to adjust net worth in connection with the merger of certain troubled institutions, and we understand that they will be using the program more extensively in the future. In our opinion this is exactly what is needed to accomodate thrift institution net worth problems.

H.R. 5568

Mr. Chairman, although we remain committed to working together with you in addressing the problems that prompted Chairman St Germain to introduce H.R. 5568, our objective is to obtain a solution to thrift industry problems that will minimize the cost to the Government and maintain the framework in which depository institutions have been able to serve the needs of their communities and the nation at large. We have examined H.R. 5568 carefully and have concluded that it is unnecessary. Moreover, we believe that certain parts of it would in fact harm the thrift industry.

Under the current regulatory system the responsibility for maintaining solvency and ensuring profitable operation of thrift institutions resides first with the institutions themselves. The Federal insurance agencies share responsibility for insured deposits and so they assume a supervisory role in assuring that, by their own standards, an institution is operating so as to protect the integrity of insured deposits. Mandating that institutions operating with losses automatically qualify for restoration of net worth to some arbitrary level absolves both the institution and the agency of a substantial portion of their responsibility for protecting the income stream of the institution. Providing continuing replenishment of subsequent earnings losses further constrains the insurance agencies from taking corrective action they may deem necessary.

The Federal deposit insurance agencies are experienced in adapting their current range of remedial measures to individual institutions that are quite different with respect to financial structure and outlook, competitive market position, and other relevant factors. A rigid legislative assistance program with fixed terms can not be developed to meet all the circumstances the regulators encounter. H.R. 5568 is addressed to a broad financial need, but it does not provide sufficient flexibility to the regulatory agencies, flexibility necessary for ICC structuring features.such as eligibility, repayment terms, yield, level of net worth restoration, and treatment of future asset growth. Trying to make some statutory rule a common denominator will result in an inefficient and possibly damaging program.

With regard to its specific focus on housing, it is not clear to us that H.R. 5568 will generate additional funds for home building. Moreover, we are concerned about the specific requirement that 50 percent of an institution's net new deposits be used to issue mortgages at a rate of interest not more than one percent greater than the average cost of funds for the institution. This provision would further exacerbate the earnings and net worth problem of the institutions the bill is designed to help. In November 1981, insured savings and loan associations were earning 10.40% on their assets and paying 12.04% for their funds. Charging no more than 1% greater than average funds costs would not close the earnings gap, but more importantly, it probably would not even cover the cost of the funds used for the loans because new funds now cost more than the average. The Money Market Certificate (MMC) ceiling rate for March 16-22 was 13.2% and the ceiling rate for thrift Small Saver Certificates (SSCs) was 14.1%. Over half of the savings and loan industry deposits are held in MMCs and SSCs, and another ten percent of deposits are held in large certificates of deposit with no ceilings. What is accomplished when savings and loan associations must pay 14% or more for new money but can charge only 13% for the loans made with those funds?

In addition, I would point out that savings and loan institutions are continuing to invest principally in housing. During 1981 the net increase in mortgage loans outstanding at savings and loan associations contributed to 46% of the total increase in savings and loan association assets. Increases in mortgage backed securities were another 18% of the asset increase. As a result, mortgage related investments continue to constitute more than half of the total increase in assets even at a time when savings and loan associations might naturally try to arrange for greater diversity in their portfolios. H.R. 5568 would have had no effect over the past year, since there were no net new deposits and therefore no funds to which H.R. 5568's investment requirements would have applied. Even if interest credited were included in the definition of net new deposits, as we believe it should be, only $6.7 billion in housing investments would have been required in 1981. The $20.8 billion increase in mortgage loans outstanding and mortgage backed securities was triple the size of this deposit increase.

All of this leads me to conclude, Mr. Chairman, that H.R. 5568 does not advance our mutual objectives. Assistance to troubled depository institutions provided in the bill is not likely to be greater than that available through existing programs, and indeed the reinvestment requirement may be harmful to thrift institutions. We should observe carefully as the insurance agencies exercise existing authority and expand their use of the ICC program, rather than attempt to revise their authority before it becomes apparent that they need our assistance.

In summary, we believe that the thrift industry can successfully weather the current adverse economic environment. It will need some help, but the wherewithal for that assistance is already available from the FDIC and FSLIC. If additional money or powers are needed by the agencies, the Administration will join the Congress in responding to that need. In the meantime, we should encourage the use of ICCs where appropriate and provide legislation supporting private solutions to the industry's problems, such as authorizing interstate and inter-industry mergers of troubled institutions, preempting due on sale clause prohibitions and preempting state usury ceilings.

Most importantly, we must remove the legal restrictions on thrift institutions' lending and investment activities as H.R. 4724 and S. 1720 would do. No public policy dealing with this industry would be sufficient if it did not attempt to deal with the industry's structural problems. The public must not be forced to cope with a troubled thrift industry and inadequate funds for housing everytime short-term interest rates rise.

* * *

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

TREASURY NEWS

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

For Release Upon Delivery
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TESTIMONY OF THE HONORABLE MARC E. LELAND
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS
BEFORE THE
SENATE FOREIGN RELATIONS COMMITTEE
ON THE CARIBBEAN BASIN INITIATIVE
MARCH 25, 1982

Mr. Chairman, I welcome the opportunity to appear before your Committee to discuss the Caribbean Basin Initiative. This is a foreign policy program of high priority for this Administration and I hope we will be able to move forward quickly with it. The package we are proposing has been carefully crafted over the past several months and is aimed at addressing the serious economic problems which confront the nations of the Caribbean and Central America. Through it we hope to be able to help its beneficiaries establish the foundations for more stable and sustained economic development and enhance their ties with the United States.

Nature of the Problems of the Countries in the Region

The Caribbean Basin Initiative includes about two dozen countries with a total population of about 41 million. Combined GNP is about $40 billion, or $975 per capita but it ranges from less than $300 annually in Haiti to over $3000 annually in the Bahamas. These countries exported a total of about $10 billion to the U.S. in 1980, but only $4 billion if petroleum is excluded.

Although the countries of the region are quite diverse in terms of size, resource endowment, and heritage, many of them suffer from a number of common economic problems. Nearly all have been hard hit by the precipitous rise in energy costs since 1974 which have increased their petroleum import bills on average by more than six fold. Costs of financing other imports, notably capital goods and food, have also risen rapidly.

On the other hand, most of them are heavily dependent on one or a small number of primary products for the bulk of their export earnings. In general, price increases for these products

have not kept pace with those of imports. The result has been a foreign exchange squeeze which has produced increasingly serious balance of payments difficulties, particularly for some of the larger countries.

At the same time, rising interest rates in international financial markets over the past few years have made it more difficult and expensive for them to borrow. In some instances, such borrowing was not even a possibility because of the perception that the prospective borrower was not creditworthy. This has made it difficult to obtain both the financial and real capital necessary to produce an acceptable rate of economic growth.

Another problem is limited market size. Virtually all of the countries in the area have populations of less than 7 million people and several have less than one hundred thousand. While strong efforts have been made to promote greater economic integration among these countries, in some cases with success, the expansion of intra-regional trade has been far from sufficient to meet their needs. Nor does such integration alone have the potential to do so, given that these nations are already poor and lack the means to create sufficient demand.

Most of the area's economies are also heavily dependent on public sector spending and investment to stimulate growth. The private sector is relatively weak and has been made even more so by the depressed economic conditions widely prevalent in recent years. In some cases inappropriate development strategies have aggravated these problems.

Political upheavals have also had a negative impact. In several cases such turmoil has produced a prolonged contraction in economic activity with an incalculable economic and psychological impact on the people involved. Real standards of living have fallen dramatically from already low levels, thereby contributing to further social unrest. In El Salvador, for example, real GNP has declined by 20 percent over the past two years. During the 1970's Jamaica suffered seven consecutive years of negative growth and is only now beginning to recover.

I need not dwell on the implications for the United States of the problems just described except to say that obviously it is not in our best interests to allow them to persist. Many of the potential beneficiaries are already trying to implement the necessary economic adjustment measures. Several countries have undertaken IMF supported stabilization programs and others are in the process of negotiations with the IMF.

But these problems are difficult and the negative economic environment they have created has tended to be self-perpetuating. They will not be overcome unless they are addressed resolutely

with the proper mix of internal economic policies and external assistance. Sound monetary, fiscal, and other economic policies which allow market mechanisms to operate as freely as possible are of paramount importance. We intend to use our program to help induce recipient countries to move in this direction. With the proper responses it can help create the necessary environment to make their economies stronger and more self-sufficient.

The Proposed Program

The heart of the Administration's proposal is a free trade arrangement which will allow beneficiary countries improved access for their products to the U.S. market. It is evident that such trade opportunities are critical to the ability of developing countries to provide the necessary stimulus to their economies. One has only to look at the experiences of the newly industrialized countries of Latin America and Asia which have emerged over the past decade. In every case a the creation of an environment favorable to rapid export growth has been a key element of their success. We expect that this will be a major drawing card for new investment in the region to take advantage of these improved market possibilities and lower cost structures.

As an additional and reinforcing inducement for investment we are proposing an important tax incentive for potential investors in the area. This is the investment tax credit of up to 10 percent of the cost of machinery and equipment used in qualifying beneficiary countries. This incentive will increase labor productivity and help to encourage the employment of labor. It will promote productive investments which will stimulate the economic development of the region.

These two elements of the program -- trade and tax incentives -- are primarily aimed at encouraging medium and longer term development. But many countries require an immediate injection of financial resources to purchase imports to keep their economies going. Thus, the Administration is also proposing a $350 million aid supplemental this year to help countries meet their immediate needs. The bulk of these funds would go to a few countries -- Costa Rica, the Dominican Republic, El Salvador, Honduras and Jamaica -whose balance of payments problems are most pressing. These funds along with the other elements of our FY 82 aid program can both relieve the immediate financial problem and create an incentive for economic reforms required to assure sustained economic growth over the longer term.

Impact on the U.S.

The Administration's proposal is not a one way street. It promises to reap subtantial benefits for the United States. Obviously it is in our own best security interests to help insure that our neighbors are healthy and prosperous. But there are other potential gains for us as well. The improved access of

Caribbean products to the U.S. market promises to benefit our consumers through lower prices. Also, as the economies in the region expand, new market opportunities will arise for U.S. producers.

This program is not expected to exert much, if any, adverse effect on the U.S. economy, either in the short run or over the longer term.

To give you an idea of the possible economic impact of the program on the U.S., it is useful to look at the current level of dutiable imports from the Caribbean and how these might change under our program. In 1980 duties were collected on $800 million in imports from the Caribbean and Central America, excluding textiles and apparel. With the elimination of tariffs, even if these import figures doubled or tripled over the next few years the impact in the U.S. would be negligible.

Of course, this in itself may not be a good measure of the possible impact because we would expect the program to promote a dynamic response and help to promote new industries since exporting now would be more attractive. Another point of comparison, then, is our experience with the GSP program. Since its inception in 1975 duty-free imports under this program have grown to slightly more than $8 billion last year. Of course, this includes imports from countries such as Brazil, Korea and Hong Kong with much greater production capacities than any of the potential beneficiary countries. Even if the program were spectacularly successful the additional exports which it would generate almost certainly would not even approach this figure. But this in no way diminishes the importance of the program. Given the size of the economies it would be helping, we expect it to be of substantial benefit to them.

Tax Incentives

The tax incentives may be divided into two parts: (a) the extension for 5 years of the investment tax credit aimed at promoting investment in the Caribbean Basin countries and; (b) the expansion of the property eligible for the investment tax credit and other incentives which are intended to restore the favored tax status of Puerto Rico and the Virgin Islands.

The Caribbean Basin investment tax credit is designed to encourage investment in machinery and equipment in qualifying Caribbean Basin countries. Generally, it is not extended for buildings or other structural components. This incentive was selected because it requires the investor to make a productive investment in order to qualify. The additional real capital which it generates will help to strengthen the production base of the region's economies, improve labor productivity, and stimulate new employment. At the end of five years, consideration may be

given to an extension of the credit on a bilateral basis through a tax treaty. A decision regarding extension of the tax credit, both to existing and new treaty partners, will not be made without full consultation with interested Congressional Committees.

As a prerequisite to qualify for the tax credit a country must enter into a bilateral agreement with the United States for exchange of information for tax administration purposes. Treasury believes that such agreements are useful because they will help tax administrators in both countries. The U.S. will benefit in particular by access to information which is needed to properly administer the investment tax credit and other U.S. tax laws. Moreover, since some countries in the Caribbean are tax havens used to contravene U.S. tax laws, they should not benefit from these tax incentives unless they are willing to cooperate with the U.S. on tax matters.

The extension of the investment tax credit for Caribbean Basin property is not inconsistent with this Administration's strong policy against use of our tax treaties for conduit investments in the United States by residents from countries other than our treaty partner. Our opposition to such tax treaty abuse is sound international tax policy and consistent with the objectives of the Caribbean Basin Initiative. The purpose of the Initiative is served by encouraging increases in productive economic activity and self-sustaining growth in the Caribben Basin countries. This purpose is not served by creating or sustaining tax haven activity which is contrary to U.S. tax treaty policy, undermines the operation and administration of the Internal Revenue Code, and fosters an increased dependence by the tax haven country on the United States.

A part of the U.S. longstanding special relationship with Puerto Rico and the U.S. Virgin Islands has been favored tax treatment of taxpayers operating in these jurisdictions. The passage of the Economic Recovery Act of 1981 unintentionally reduced the effectiveness of this special treatment. At the same time, the extension of the investment tax credit to the Caribbean Basin will encourage investment there, perhaps to the disadvantage of Puerto Rico and the U.S. Virgin Islands. In light of these facts the Administration proposes to extend to them additional tax incentives for investment.

Most U.S. corporations operating in Puerto Rico and the U.S. Virgin Islands currently benefit from special provisions in the Internal Revenue Code (principally sections 936 and 934) which effectively eliminate Federal tax on income from a trade or business there. Puerto Rico and, to a certain extent, the U.S. Virgin Islands, in turn, grant tax holidays for most manufacturing operations. These corporations have not been eligible for the investment tax credit and the benefits of accelerated cost recovery deductions (ACRS) for property used predominately in Puerto Rico or a possession.

The proposed legislation allows these corporations the investment tax credit. Since such corporations generally pay little or no tax in the U.S., they are unable to use these tax benefits to reduce their tax liabilities in the U.S. The proposed legislation therefore also allows such domestic companies to pass the investment tax credit and a portion of the tax benefits of ACRS to their parent corporations in the U.S. This will restore the relative preference for investment in Puerto Rico and offer an important incentive to investment in the Virgin Islands.

Finally, the legislation provides for some modifications in the disposition of excise taxes collected on rum. Puerto Rico and the Virgin Islands currently provide about 90 percent of the U.S. rum market and, at present, the entire amount of U.S. excise taxes collected on rum produced there is transferred to them. Since the Act proposes to reduce import duties on rum produced in other Caribbean Basin countries, the Puerto Rican and U.S. Virgin Islands' share of the U.S. rum market may decrease. This could adversely affect the rum industries in Puerto Rico and the U.S. Virgin Islands and reduce the amount of U.S. excise tax collections the island governments currently receive. To maintain this revenue source the legislation provides that excise taxes collected at the current rates on rum imports into the U.S. from <u>any</u> country will be transferred to Puerto Rico and the Virgin Islands, provided that the amount transferred will not exceed the amount per proof gallon which would be paid over if the rum was produced in Puerto Rico or the U.S. Virgin Islands.

<u>Conclusion</u>

The Caribbean Basin Initiative is a bold and imaginative package which promises to reap substantial benefits both for beneficiary countries and the United States. It will embody a substantial increase in U.S. economic assistance in support of a concerted effort on the part of the Basin Countries to pursue appropriate economic policies and offer them the chance to take advantage of new opportunities in the U.S. market as well as important incentives for new investment. It will help to restore greater stability to the region and strengthen mutually beneficial ties with the U.S. I would urge the Congress to move ahead quickly with the legislative proposal so that we may begin to implement the program as soon as possible.

TREASURY NEWS

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TESTIMONY OF THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY
BEFORE THE
HOUSE BUDGET COMMITTEE

Mr. Chairman and Members of the Committee,

It is a pleasure to be with you today to discuss the economic outlook and the Budget. I hope this occasion will be part of an on-going dialogue between the Committee and the Administration over the need to restore a stable fiscal climate to promote long-term noninflationary growth in the American economy.

As you know, the economy continues in the grip of the second recession in two years. This latest downturn began in July 1981, hard on the heels of the sharp recession of 1980, from which the economy had never really recovered. The causes of the two downturns are clear: years of excessive money growth, rising inflation, rising interest rates, rising tax rates, and rising Federal spending as a share of GNP.

With the help of this Committee, we hope to continue the fight to bring Federal spending and deficits under control. With the help of the Federal Reserve, we hope to bring inflation and interest rates down. These steps will lead to an early end to the current downturn.

In spite of the continued slide in the first quarter of 1982, there are some hopeful signs. Excess inventories are being drawn down at a rapid rate. This is typical of the last stages of a recession. Retail sales are rising. Housing starts are up slightly. Durable goods orders have leveled off. And, very important for the financial well-being of all Americans, whether of working age or retirees, inflation continues to fall.

More importantly, we have in place a sound long-run tax system for the 1980's. It will not only help bring an early end to the current recession, but will promote rapid growth of income, savings, investment and employment for years to come. That tax system, with a healthy economy, will generate as much revenue as government should reasonably be allowed to spend.

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However, the short-run revenue picture has been heavily affected by two factors: the recession and the drop in inflation -- one bitter pill and one piece of candy which together have significantly decreased revenue to the point of causing large deficits. The recession is temporary, and the decline in inflation is most welcome.

Nonetheless, nominal GNP is estimated to be 4 percent lower than was forecast last March, and the 1982 unemployment rate over one and one-half percentage points higher. These changes in economic assumptions have added roughly $60 billion to the deficit projections for FY-1983 compared to our estimate last year. Higher interest rates and a higher level of national debt by FY-1983 have added $30 billion more.

We, therefore, had to face some tough decisions about how to cover the costs of some very important government programs -- how to make up the difference between the $666.1 billion in revenues and the $757.6 billion in outlays -- until the growing economy triggered by our reformed tax system brings growing revenues into line with restrained outlays.

Some have urged us to revoke the incentive-creating tax cuts already in place. The result would have been lower real growth for many years into the future. It would have involved a self-defeating major change in a permanent tax program to handle a temporary problem. Instead, we shall propose certain worthwhile tax reforms, upgrade our tax collection program, renew our efforts at controlling spending, and borrow to cover the remaining deficit.

Deficits are not good. They rob the private sector of financial and real resources needed for growth, and divert those resources into government consumption. So do taxes. The root of the problem is the Federal spending which appropriates those real resources and then must find the means to pay for them in one way or another.

The budget deficit can and must be narrowed from the spending side. For too long, spending has been rising faster than the economy has grown. The economy can no longer support the burden. Some progress was made last year in reducing the runaway rate of growth in Federal non-defense spending. Further efforts will be required this year and into the future.

Insofar as spending is not reduced, it is preferable to close the remaining transitional recession deficits of the sort now being experienced by borrowing rather than by taxing. The funds are pulled from the private sector in either case, but taxes impose a larger cost in terms of reduced incentives for real growth.

Borrowing takes a portion of current national savings out of current national income (which equals current net output) to enable the government to gain command over a portion of current output. Taxing also enables the government to have at its disposal a portion of current output. Like borrowing, taxation reduces the supply of savings for investors to borrow by a substantial amount.

However, there is a difference. In recent years, tax increases have generally taken the form of allowing inflation to push taxpayers into higher brackets, or allowing inflation to erode the value of depreciation allowances. The former reduces the value of incremental present or future wages and interest income; the latter reduces the rate of return on plant and equipment. The effect is to reduce the supply of labor, savings, plant and equipment, cutting down on future output. Thus, taxation often produces disincentives which adversely affect future output, as well as directing a portion of current output to the government.

Federal borrowing creates debt that must be serviced, and this implies the future payment of taxes, but it need not require an increase in marginal tax rates, as long as economic growth produces an enlarged tax base. Thus, borrowing should have less adverse impact on future output than taxation.

Therefore, in deciding how to cover the transitional deficits associated with the current recession, we feel it is better to borrow, while leaving the tax incentives in place for long-run growth, rather than to undo the structural tax reforms of the ERTA, which would choke off future expansion.

We must continue to strive to reduce the deficit by curtailing spending and promoting real growth. The budget we are proposing take major steps toward closing that deficit over the next several years. In the interim, it can be handled in a nondisruptive fashion. The first three charts help to put the deficit into perspective.

The projected deficits, though some of them are at record dollar levels, are not unusual following a recession when measured as a percent of GNP. On- and off-budget deficits were 3.6 and 4.5 percent of GNP in Fiscal Years 1975 and 1976, due largely to the 1974-1975 recession. Deficits are projected to be 3.8 percent and 3.1 percent of GNP in Fiscal Years 1982 and 1983, largely as a result of the current recession.

There has been considerable concern that our projected deficits will put extreme pressure on credit markets and thus drive up interest rates. However, we believe there will be

ample private sector saving to finance these deficits without excessive pressure on the credit markets or inflationary money creation by the Federal Reserve.

In the past, deficits were often accompanied by falling interest rates. It should be particularly true this time, with falling inflation and a savings-oriented tax program in place. The deficits will be manageable because of the growth of private sector saving.

Private saving resulting from normal year-over-year growth and the Economic Recovery Tax Act will be several times greater than the total borrowing requirement of the Federal Government in 1983 and 1984 and thereafter.

The net additions to total private saving are larger than the rise in the deficit. They will produce "crowding in" rather than "crowding out." This extra shot in the arm of capital markets will put downward pressure on interest rates. Even after financing the Federal deficit, there will be billions of additional dollars each year for private investment.

Normal year-to-year increases in saving exceed $40 billion each year. This will be supplemented by the additional personal savings and additional business retained earning induced by the tax cuts.

Compared to 1981, private saving will be more than $60 billion higher in 1982, more than $170 billion higher in 1983, and more than $260 billion higher in 1984. Private saving was $480 billion in 1981. It is projected to rise to more than $740 billion in 1984.

It has been lack of growth, more than anything else, that has been responsible for the current and projected deficit. As a rough rule of thumb, each time growth falls off by enough to produce a 1 percent increase in unemployment, the budget deficit widens by more than $25 billion. In fact, if we had grown fast enough over the past four years to get unemployment down below 6 percent, the current deficit would be roughly $75 billion lower.

Growth is the only way to balance the budget while promoting rising real income and employment. I would like to point out, very firmly, that any changes in the economic recovery program which reduce real growth will tend to worsen the budget picture. Changes which reduce individual or business saving by as much as or more than the deficit will only worsen the situation in the credit markets.

The budget is not merely an accounting document. One cannot simply take a billion dollars out of column A and put

it in column B. There are behavior changes and economic repercussions from tax and spending shifts which affect saving, investment, labor supply, income and revenue. Very often, changes which may look good on paper will buy little or no progress toward solving a budget problem, especially compared to the economic cost to the whole nation of the policy shift.

These facts should be kept clearly in mind as we look at the deficits in this budget.

Taxation, Spending and the Budget

The tax code we have in place, plus the tax proposals contained in the Administration's budget regarding obsolete provisions and improved tax compliance measures, will generate as much revenue over the long term as the government should reasonably be allowed to spend. We project long-term receipts of between 19 and 19-1/2 percent of GNP between 1983 and 1985 under our proposals. These percentages would rise slowly thereafter with real economic growth and scheduled payroll tax increases. This compares with 18.7 percent from 1964 through 1974 and 19.0 percent from 1975 through 1979. Receipts were 20.1 and 21.0 percent of GNP in 1980 and 1981, respectively, and will be approximately 20.3 percent in 1982. Receipts, therefore, will be in line with, or even higher than historical levels.

On the other hand, spending, on- and off-budget, is already too high and threatening to go higher. It was 23.0 and 23.7 percent of GNP in 1980 and 1981, respectively, and will exceed 24 percent of GNP in 1982. This compares to 19.8 percent from 1964 through 1974 and 22.1 from 1975 through 1979. We have recommended a decline to just over 21 percent of GNP by 1985, and further declines thereafter.

There is a general perception that spending and taxes have been slashed. In fact, all we have done so far is to reduce the rate of growth of spending, and we have just begun to see a modest tax reduction.

The personal tax rate reductions in the ERTA are not substantially larger between 1981 and 1984 than the continuing bracket creep and the payroll tax increases of 1981 and 1982. In fact, there was a net personal tax increase of roughly $15 billion in 1981. In 1982, taxpayers will barely break even. Not until 1983 and 1984 will there be real tax cuts for most families, totalling $12 to $15 billion each year. Taxes will rise again in 1985 due to a scheduled payroll tax increase.

On the other hand, even under our proposed spending restraint, spending will remain well above long-term averages for several years to come. If major budget changes are to be made, they should be in spending levels, not taxes.

Importance of a Stable Tax Policy

It is unlikely in the extreme that tax increases could succeed in balancing the budget. First, they would weaken the economy, and be partially offset by slower growth. Second, they would encourage higher spending. In spite of the fact that the tax receipts of the Federal Government rose nearly $250 billion from FY-1977 to FY-1981, the government ran deficits of nearly $200 billion.

Consequently, the Administration hopes to balance the budget by restraining spending and encouraging growth through a stable incentive-creating tax program.

Business Taxes

Stability in tax policy is essential for private sector planning and economic recovery. Consider the impact of sudden changes in the tax law on the cost of plant and equipment and the related investment decisions.

Millions of firms planning billions of dollars of investment decisions must be in a situation of great uncertainty with respect to leasing, ACRS and other provisions. There is no way for a firm to determine whether an investment is practical or not until the tax picture is clarified. The decisions of the Congress regarding ACRS and related provisions have the power to unleash a flood of investment or to choke off tens of billions of dollars of spending on modernization and expansion of plant and equipment. Until the political decisions are made, the economic decisions, and the economic recovery, are on hold. The right decisions will start the economy climbing. The wrong ones will set it tumbling.

Taxes on Saving

Consider the impact on personal saving of a decision to suspend the third year of the tax cut and indexing. Under current law, over the life of a 10-year bond purchased in 1983, a taxpayer who will be in the 33 percent bracket following the third year of the tax cut would pay roughly one-third of his interest to the government. But without the third year and indexing, that tax rate would start at 39 percent and rise within a decade to 44 percent and 49 percent, as the taxpayer's income rises through the tax brackets with inflation. The average of these tax rates would probably be nearly 44 percent compared to roughly 33 percent under current law.

At a 10 percent nominal interest rate and 5 percent or 6 percent inflation, this rise in the tax rate would be enough to cut a 2 percent real after-tax interest rate in half, or a 1 percent real after-tax interest rate to zero. Historically, such swings in the real after-tax interest rate have shifted the personal savings rate by one or even two percentage points. This would be enough to remove $25 to $50 billion dollars per year from the credit markets over the next decade, with obvious adverse consequences for interest rates, investment, and real growth.

Furthermore, the potential saver would know as soon as these provisions were repealed what the impact would be on the rate of return to saving. He would react at once, before the bond were purchased, not 5 or 10 years later after having committed money in good faith.

Taxes on Labor

There are those who would preserve the business portions of the ERTA, and cancel most of the remaining individual tax rate reductions. Such a move would be extremely counter-productive to business as well as to individuals. I am frankly amazed at the lack of thought behind such proposals.

In my years at Merrill Lynch, I came to appreciate the importance of the individual in his or her role as saver, investor and entrepreneur. I am surprised that others in commerce or industry do not appreciate the importance of the individual in the roles of employee and customer.

Those who think of business only in terms of large corporations forget the millions of partnerships, proprietorships and sub-chapter S corporations whose profits are taxed at the individual level at individual tax rates. The decisions of these owner-investors and entrepreneurs are heavily influenced by the personal rate reductions and estate and gift tax reforms recently enacted.

As for employees and consumers, consider the effect of suspending the third year of the tax cut and indexing on the cost of labor and the standard of living of the American family.

Total net output of goods and services in the economy results from the combination of labor and capital. The value added by these two factors of production is reflected in the wages, salaries, rents, royalties, interest and dividends they receive. Value added equals total national income and total net output.

It may come as a surprise to some, but labor is far and away the larger of the two factors. Value added by labor is

between two-thirds and three-quarters of the total in most years for most products and industries. Labor inputs outweigh capital inputs two or three to one. It is time to remember that taxes on labor and the resulting higher labor costs are extremely damaging to American business.

Over the last 15 years, inflation, bracket creep and payroll tax hikes have sharply increased the pre-tax cost to the firm of giving a worker a one dollar after-tax wage increase.

A median income worker now faces 40 percent to 44 percent tax rates on added income. This is the sum of social security and Federal marginal income tax rates, plus state and local taxes at the margin. It is up sharply from the late 1960's, when the marginal rates would have been roughly 26 percent to 30 percent.

Consequently, it now costs a firm more than $1.70 to compensate a worker for a $1.00 increase in the cost of living. This is up from $1.40 in the late 1960's. Without indexing, it will rise to $2.00 by the late 1980's, and to $2.50 or higher in the 1990's. Any wage increase, whether merely COLA's or a real wage hike, would send taxes rising and tend to push labor costs up faster than the prices the firm receives for its products. Profits, employment, or real wages would tend to fall continually over time in the absence of extraordinary productivity increases. The competitive position of U.S. labor in the world economy would suffer.

The likely consequence of such a tax situation will be a falling after-tax wage. Labor will absorb a substantial portion of the tax burden. The cost of eliminating the third year of the tax cut and indexing to a wage earner making $20,000 in 1982 and receiving a cost-of-living increase thereafter would be substantial: $80 in 1983, $203 in 1984, $289 in 1985, and $369 in 1986. This is only the direct cost. The weaker economy, reduced saving, investment and growth, lower productivity and reduced demand for American labor would lower the market wage itself, reducing the family's real earnings by two or three times the direct cost of the higher taxes. American workers and savers are the primary customers of American business. There is no way such an impact on the real income of its customers would be good for business.

Importance of a Stable 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 by 5 percent in 1981. December to December, the rate was 6.4 percent due to rapid money growth at year's end. 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 was initially much more rapid -- almost three-fourths of the planned reduction in the first year -- until end-of-year increases in money growth rates raised the level of M1B above the lower end of last year's target range. Currently, the level of M1 is $4 billion above the target range for 1982.

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 reductions in real output, employment, and real income. Lower inflation and lower real output mean lower GNP and lower Federal tax revenues. Lower inflation also means lower Federal outlays on indexed programs, but only with a considerable time lag. In the interim, the deficit widens. 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.

There are those who are urging the Federal Reserve to abandon its goal of a steady and moderate growth rate of the money supply. They believe that faster money growth would depress interest rates. History does not support that view, as the attached charts show.

For many years, it has been apparent that inflation is the main factor determining the level of interest rates. Excessively rapid money growth in the past has brought about

the current high levels of interest rates. As inflation has risen or fallen in the past, interest rates haved moved in step.

In the last year or two, however, interest rates have risen relative to the inflation rate. This may be due, in part, to the unusual volatility of money growth rates since 1980.

In the last two months of 1980, M1 fell at an annual rate of 1.4 percent per year, after a sharp rise in the previous five months. All of the growth in M1 in 1981 occurred in the first four months of the year, when it grew at a 14.2 percent annual rate, and the last two months of the year, when M1 growth was at a 11.6 percent rate. In the interim, M1 oscillated from week to week. In the six months from April to October, the net change was a decrease of 0.2 percent, annual rate.

Early 1982 saw a very rapid increase in the money supply through January, followed by a levelling off in February as the Fed has tried to bring M1 back inside its target range. The rapid growth of money from November through January was accompanied by rising interest rates, reversing the dramatic decline in interest rates that had been under way since September.

The evidence of the past two years is very clear:

- Volatile money growth undermines 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.

- Faster growth of M1 and the monetary base is associated with rising interest rates. Slower growth of M1 and the monetary base is associated with falling interest rates.

The Administration strongly supports the Federal Reserve's announced goal of a steady and moderate rate of growth of the money supply, not because we seek to drive interest rates up, but because it is the only known way to bring inflation and interest rates down on a permanent basis.

It is easy to illustrate why the financial markets watch the money supply so closely, and why variability of inflation and interest rates creates turmoil and uncertainty in the bond markets. Old securities must fall in price to remain competitive with new issues as interest rates rise. Conversely, bond prices rise when interest rates fall. Consider the history of the Treasury's 6-3/4 percent 20-year bond issued on October 1, 1973, priced at $99.50 per $100 of face value

to yield 6.79 percent. Its value over time has fluctuated substantially with market interest rates:

	Price	Yield to Maturity
9/30/74	84.63	8.41
9/30/75	85.69	8.32
9/30/76	92.19	7.59
9/30/77	95.44	7.25
9/30/78	86.06	8.44
9/30/79	80.19	9.38
9/30/80	69.69	11.37
9/30/81	55.75	14.96
latest	62.50	13.38

As interest rates and bond prices have become increasingly unstable in recent years, the risk involved in buying bonds has increased. This has resulted in greater reluctance to buy bonds on the part of those who cannot afford a risky porfolio, and the emergence of a risk or volatility premium which has driven interest rates higher than normal relative to inflation in recent years. This is why stability in the rate of money growth and interest rates is critical to the success of our program.

APPENDIX

Full Employment Deficit

One way to illustrate the impact of the back-to-back recessions of 1980 and 1981-1982 on the budget deficit is to examine the high employment budget deficit. This concept has been used in the past to measure the "stimulus" of budget policy, on the theory that deficits increase total spending and pump up "demand". We reject the notion that deficits per se are inherently stimulative. They must be financed by borrowing in the absence of inflationary monetary creation. Nonetheless, the one useful insight the high employment budget does provide is a measure of the fundamental relationship between the current policy level of spending and the current tax code's capacity to generate revenue with the distorting effects of the recession removed. I am happy to comply with the Chairman's request to present the high employment figures.

The high employment budget estimates the budget aggregates that would result if the economy were continuously operating at a high level of employment under the tax and spending proposals contained in the FY-1983 Budget documents. The unemployment rate at high employment is traditionally estimated for this purpose to be about 5.0 percent. (However, many observers feel the real economy has a long-term basic unemployment rate somewhat higher.) Potential real GNP is assumed to grow 3.2 percent annually. (We believe this potential growth rate can be increased by proper policies, but have conformed to convention to provide estimates consistent with those of earlier years.)

The CEA has estimated the high employment deficit through FY-1985 on a unified budget basis. (The high employment deficit can be computed on a national income accounts (NIA) basis or on a unified budget basis. The major differences are the inclusion of offsetting receipts from oil and mineral leases and asset sales and the netting out of Federal retirement receipts and outlays in the unified budget.) The figures are available through FY-1985:

	FY 81	FY 82	FY 83	FY 84	FY 85
Receipts	636	691	723	768	830
Outlays	644	702	739	793	860
Deficit (-)	-8	-11	-16	-25	-30

It is clear from the tables that the major portion of the projected deficits of nearly $100 billion in FY-1982 and FY-1983 is due to the fact that the economy is operating at less than full employment. The phased tax reductions result in small year-to-year increments in the high employment deficit, and,

even in "demand" terms, cannot be regarded as large or excessively stimulative. The bulk of the deficit increase, from $11 to $25 billion, is completed by FY-1984. By FY-1985, high employment receipts grow 8.1 percent over FY-1984, nearly matching the growth of outlays at 8.4 percent.

Savings Flows and How They Fit into the Scenario

The following outlines some of the concepts underlying the gross and net private savings figures commonly cited and provides background on the savings numbers consistent with the economic scenario underlying the budget. By whatever savings measure one prefers, projected deficits as a share of savings are less than in the 1974-1975 recession and the subsequent recovery, and are declining. I am happy to submit these comments at the Chairman's request.

Concepts

- In the National Income and Product Accounts (NIPA), gross private saving is the sum of:

  - Personal saving -- the difference between after-tax personal income of the household sector and outlays of that sector for consumer goods and services, interest payments, etc.

  - Corporate saving, consisting of depreciation allowances plus undistributed after-tax profits. (This is equivalent to the cash flow available to corporations, both to maintain and add to productive assets. Inventory profits are excluded.)

  - Depreciation allowances of the noncorporate sector including unincorporated business enterprises plus imputed depreciation on owner-occupied homes. The latter, roughly $40 billion or about one-twelfth of gross private saving, is the only item in the saving figures which does not represent true cash flow.

- Gross private saving forms by far the larger part of total gross saving. In addition to private saving, the total includes the surplus of state and local governments (largely the surplus of the pension funds for their employees, as surpluses on operating account have been fairly narrow) and the surplus or deficit of the Federal Government. The latter is on a NIPA basis. In the next couple of years, the NIPA deficit will be wider than the more widely cited unified budget deficit (the difference arising from sales of mineral rights and other transactions that are not reflected in the NIPA but affect the unified budget).

- Table 1 attached presents historical data on gross savings flows as percentages of GNP.

- Net private saving in the accounts is comprised of personal saving and the undistributed profits of corporate business. (Profit-type income of unincorporated businesses gets into personal saving.) Depreciation allowances are not included in net saving. (The net saving figures are close to, but do not quite represent available cash for net investment, as undistributed profits and returns to unincorporated enterprises are after allowances have been made for full replacement of inventories and fixed capital used in the production process. They exclude inventory profits, and depreciation is on a so-called economic rather than book-basis, i.e., replacement rather than historical cost.) Savings or dissavings of government can be added to net private saving to get total net saving.

- Net saving figures are commonly compared with net national product (NNP, or GNP less depreciation allowances). Thus, depreciation is excluded from both numerator and denominator. Table 2 attached presents net savings flows as percentages of NNP.

- Domestic savings flows, either gross or net, may be augmented by inflows from abroad, which are likely to be attracted by the new tax climate.

- In an accounting sense, total gross saving (including any dissaving by the Federal Government) must match total gross investment -- the net additions to the stock of plant, equipment, inventories, and residential structures plus an amount sufficient to replace existing assets that have worn out or become obsolete. In any year, investment to replace existing assets far exceeds net additions to the stock of productive assets. Similarly, total net saving must equal net investment.

Gross Savings Flows in the Scenario

Savings flows consistent with the economic scenario underlying the 1983 Budget were worked up by the CEA. They were, of course, forced to fit within the constraint of the total uses of savings -- overall investment response to the rate of return changes in the ERTA plus Federal, state and local deficits and foreign flows. The breakdown between corporate and personal savings within the totals can be affected by dividend payout assumptions, capital intensity assumptions across corporate and non-corporate businesses, etc. In keeping within the totals, personal savings rates appear to have come out a bit low by historical standards.

The estimates yield substantial private savings flows, although they do not appear to be out of line with the sum of normal year-to-year growth, the business share of ERTA and historical responses by individuals to tax reductions.

- o Historically, gross private saving has averaged about 16-1/2 percent of GNP. The peak ratio in the postwar period was 18.2 percent in the recession year of 1975. The next highest ratio was 17.5 percent in 1967. (See left-hand column of table 1 attached.)

Gross Private Saving as a Percent of GNP

	Budget scenario
1956-65	16.3
1966-75	16.6
1976-80	16.7
1981	16.4
1982	17.2 projected
1983	18.5 "
1984	19.1 "

- o The impact of ERTA on gross private saving can roughly be estimated by calculating saving on the assumption that the historic 16-1/2 percent share of GNP had been maintained and comparing those numbers with the higher saving flows projected in the new scenario. The implication of these calculations is that gross private saving in the new scenario in 1985 is $101 billion more than if old saving patterns prevail.

Gross Private Saving

Calendar Year	Level in Budget (1)	Yearly Increase (2)	Level at 16.5% of GNP (3)	Difference from Budget (4) = (1)-(3)	Tax Cut ERTA (5)	Added Savings as % of ERTA (6)=(4)/(5)
	(----------- billions of dollars				-----------)	(percent)
1981 actual	480	--	--	--	--	--
1982 projected	542	62	521	21	58	36
1983 "	651	109	581	70	115	61
1984 "	742	91	641	101	151	67

- In terms of total saving flows, including government surplus, note that increased government deficits (dissaving) resulting from a tax cut have no effect on total saving if those tax cuts flow directly into increased private saving, as the funds from ACRS, which are recorded as retained earnings, might be expected to do. Of course, private saving may increase by more or less than any tax cut, depending on responses of households and businesses to changes in after-tax real rates of return on prospective investments. In the mid-1960's, personal savings increases, partly as a result of above average income growth, exceeded 70 percent of the marginal tax rate reductions for three years, rising to exceed the tax reductions in the fourth year and thereafter. The personal savings rates in the scenario assume a savings increase averaging roughly 45 percent of the personal tax cuts from 1982 to 1984.

<u>Composition of Gross Private Saving in the Budget Scenario</u>

- The rise in business saving reflects:

    1. A recovery of the profit share (before allowance for ACRS) and retention of a large portion of those increased profits, rather than their distribution in dividends.

    2. ACRS and other tax changes which reduce profits taxes by about $10 billion in CY-1982, $19 billion in CY-1983, and $27 billion in CY-1984.

    3. The depreciation thrown off by a rising stock of capital.

- The path of the personal saving rate is as follows:

	Personal Saving Rate (%) Budget scenario	
1980	5.6	
1981	5.3	
1982	6.7	projected
1983	7.0	"
1984	6.1	"

The dip in 1984 was conditioned by overall constraints imposed on the forecast, and appears to be an understatement. Personal saving available to households is related to prospective real after-tax rates of return; these should be vastly improved from returns available during the 1970's, and higher in 1984 than in 1983. Personal savings rates averaged 7.6 percent from 1965 to 1975.

Net Private Savings in the Scenario

Net saving figures indicate resources available to increase the stock of productive capital after allowance has been made for its maintenance.

- As indicated by the figures in the left-hand columns of table 2, ratios of total and net private saving to net national product (NNP) were severely eroded in the late 1970's. In 1981, net private saving was 6.1 percent of NNP compared with 8-3/4 percent during the late 1960's. The scenario shows that late 1960's ratio being restored, though not surpassed.

	Net private saving as percent of NNP	Federal deficit as percent of net private savings plus S&L surplus
1956-65	8.1	- 2.8
1966-75	8.6	-14.5
1974	7.6	-10.9
1975	8.9	-53.8
1976	7.7	-39.0
1977	7.3	-30.0
1978	6.9	-17.9
1979	6.7	- 8.6
1980	6.2	-35.0
1981	6.1	-31.8
1982 projected	7.0	-45.0
1983 "	8.7	-32.0
1984 "	8.8	-28.0

- The right-hand column of table 2 and the tabulation on the prior page show the ratio of the NIPA Federal deficit to the total net private savings plus supluses (if any) of state and local governments. That ratio hit a peak of 54 percent in 1975. As indicated on the prior page, that ratio in the scenario for 1982 never approaches the 1975 figure, and ratios for 1983 and 1984 stay below respective figures for 1976 and 1977.

GROSS SAVING AND INVESTMENT

LEVELS

	1979	1980	1981	1982	1983	1984
Gross Private Saving	400.0	434.1	478.7	542.0	650.7	741.8
Personal	86.2	101.4	106.6	150.8	171.7	163.4
Business	313.9	332.7	372.1	391.3	479.0	578.4

PERCENTS OF GNP

	1979	1980	1981	1982	1983	1984
Gross Private Saving	16.6	16.5	16.4	17.2	18.5	19.1
Personal	3.6	3.9	3.6	4.8	4.9	4.2
Business	13.0	12.7	12.7	12.4	13.6	14.9

GROSS SAVINGS

PERCENT OF GNP

	GROSS PRIVATE SAVING	PERSONAL	CORPORATE	RETAINED EARNINGS	CORPORATE CAP.CONS. ALLOWANCE	NONCORP. CAP.CONS. ALLOWANCE	TOTAL GOVT.	FEDERAL	STATE & LOCAL	NET FOREIGN INVESTMENT	GROSS PVT. DOMESTIC INVESTMENT	PERSONAL SAVING RATE
1947	11.715	2.247	6.062	2.021	4.041	3.400	6.178	5.743	0.436	3.984	14.767	3.100
1948	15.943	4.292	8.100	3.848	4.252	3.538	3.255	3.205	0.051	0.930	15.856	5.900
1949	15.080	2.896	8.370	3.767	4.603	3.832	-1.302	-1.021	-0.281	0.339	14.847	4.000
1950	14.891	4.160	6.988	2.520	4.468	3.734	2.794	3.214	-0.421	-0.645	16.416	5.800
1951	15.371	4.856	6.792	2.293	4.499	3.714	1.834	1.968	-0.134	0.266	14.779	7.100
1952	15.746	4.994	6.967	2.356	4.611	3.800	-1.087	-1.073	-0.014	0.180	14.075	7.300
1953	15.467	5.049	6.630	1.973	4.657	3.789	-1.890	-1.929	0.039	-0.348	14.423	7.300
1954	15.829	4.629	7.244	2.285	4.958	3.956	-1.948	-1.645	-0.303	0.062	14.790	6.600
1955	16.090	4.111	8.139	3.283	4.856	3.840	0.786	1.104	-0.318	0.111	15.604	6.000
1956	16.772	5.059	7.777	2.529	5.248	3.936	1.231	1.439	-0.207	0.655	15.728	7.300
1957	16.738	5.020	7.776	2.324	5.453	3.942	0.208	0.514	-0.306	1.083	15.284	7.200
1958	16.739	5.241	7.433	1.827	5.606	4.066	-2.808	-2.284	-0.523	0.199	14.101	7.400
1959	16.369	4.332	8.214	2.827	5.387	3.823	-0.324	-0.233	-0.091	-0.236	14.853	6.200
1960	15.399	3.884	7.766	2.381	5.385	3.749	0.611	0.599	0.012	0.557	14.399	5.600
1961	15.818	4.386	7.719	2.375	5.344	3.713	-0.811	-0.741	-0.070	0.728	13.813	6.300
1962	16.010	4.122	8.339	3.221	5.118	3.548	-0.670	-0.752	0.082	0.600	14.010	6.000
1963	15.566	3.669	8.443	3.419	5.024	3.454	0.120	0.043	0.077	0.740	14.234	5.400
1964	16.670	4.635	8.669	3.742	4.927	3.366	-0.356	-0.513	0.156	1.070	14.385	6.700
1965	17.316	4.871	9.171	4.336	4.835	3.275	0.076	0.077	-0.001	0.786	15.001	7.100
1966	17.014	4.756	9.052	4.234	4.819	3.206	-0.170	-0.237	0.066	0.401	14.758	7.000
1967	17.497	5.542	8.705	3.720	4.985	3.250	-1.781	-1.648	-0.132	0.323	14.069	8.100
1968	16.254	4.802	8.214	3.200	5.014	3.238	-0.683	-0.693	0.010	0.069	14.360	7.100
1969	15.216	4.300	7.591	2.443	5.149	3.325	1.053	0.893	0.159	0.042	14.773	6.400
1970	15.978	5.619	6.938	1.488	5.450	3.421	-1.065	-1.253	0.188	0.323	14.202	8.000
1971	16.734	5.628	7.642	2.115	5.527	3.429	-1.805	-2.044	0.239	-0.067	14.733	8.100
1972	15.958	4.436	8.076	2.576	5.500	3.473	-0.281	-1.418	1.138	-0.429	15.583	6.500
1973	17.166	5.953	7.788	2.435	5.353	3.428	0.590	-0.422	1.012	0.490	15.931	8.600
1974	16.353	5.935	6.749	0.936	5.813	3.669	-0.330	-0.804	0.474	0.201	14.956	8.500
1975	18.247	6.086	8.300	1.878	6.422	3.861	-4.119	-4.472	0.353	1.179	13.749	8.600
1976	17.136	4.802	8.542	2.148	6.395	3.793	-2.125	-3.090	0.964	0.298	14.321	6.900
1977	16.808	3.863	9.104	2.725	6.380	3.841	-0.956	-2.418	1.463	-0.723	15.709	5.600
1978	16.483	3.541	9.009	2.685	6.324	3.933	-0.010	-1.355	1.344	-0.639	16.381	5.200
1979	16.525	3.570	8.885	2.447	6.437	4.070	0.494	-0.614	1.108	-0.070	16.501	5.200
1980	16.485	3.857	8.366	1.687	6.679	4.257	-1.222	-2.330	1.108	0.225	15.277	5.600
1981	16.344	3.648	8.459	1.694	6.765	4.233	-0.859	-2.108	1.249	0.079	14.797	5.300
FIVE YEAR AVERAGES												
1951-1955	15.701	4.728	7.154	2.438	4.716	3.820	-0.461	-0.315	-0.146	0.054	14.734	6.860
1956-1960	16.404	4.707	7.793	2.378	5.416	3.903	-0.216	0.007	-0.223	0.452	14.873	6.740
1961-1965	16.276	4.337	8.468	3.419	5.049	3.471	-0.328	-0.377	0.049	0.785	14.289	6.300
1966-1970	16.392	5.004	8.100	3.017	5.083	3.288	-0.529	-0.587	0.058	0.232	14.433	7.320
1971-1975	16.891	5.608	7.711	1.988	5.723	3.572	-1.189	-1.832	0.643	0.274	14.991	8.060
1976-1980	16.687	3.927	8.781	2.338	6.443	3.979	-0.764	-1.961	1.197	-0.182	15.638	5.700

Table 1

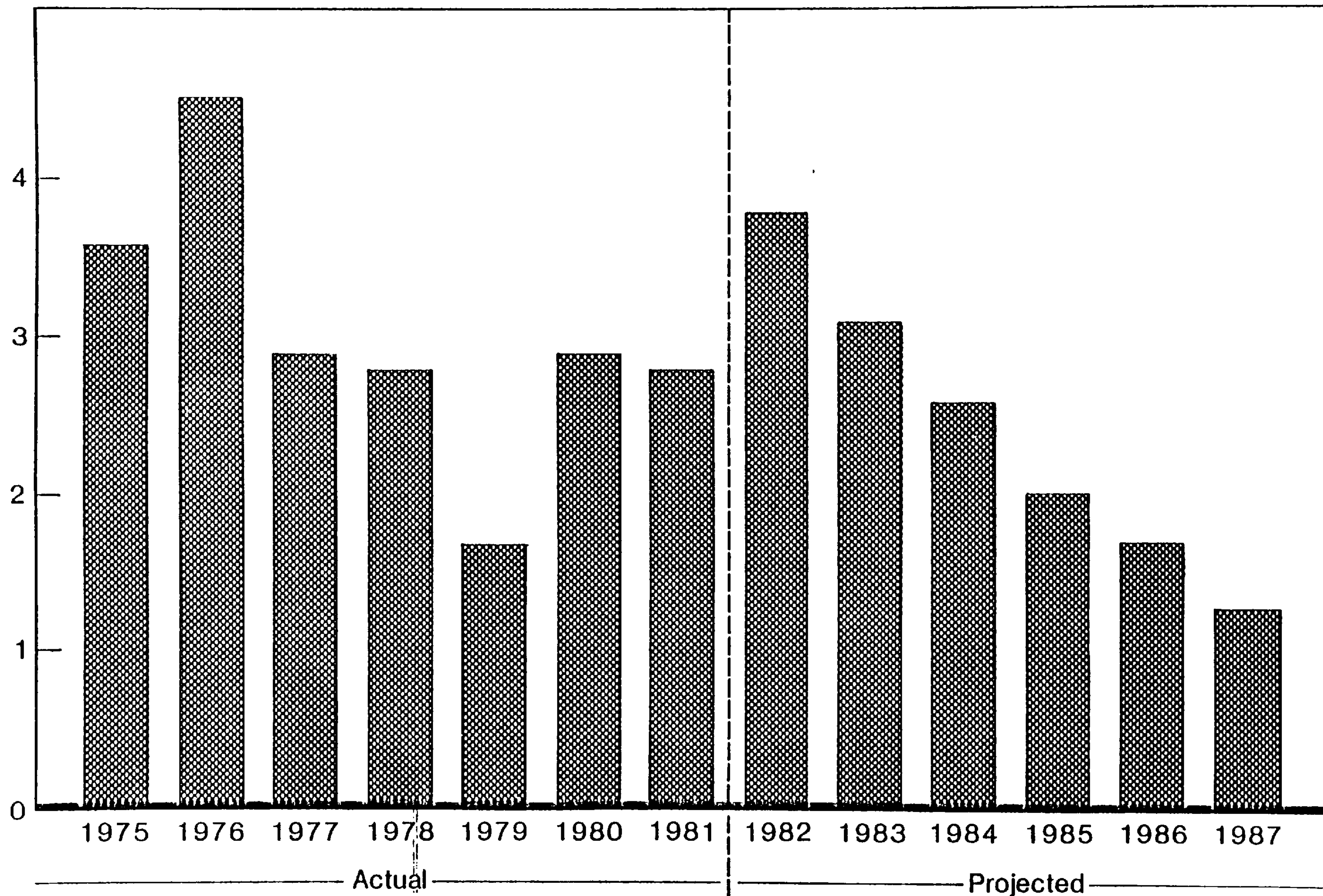
Table 2

2/9/82

NET SAVINGS

	PERCENT OF NET NATIONAL PRODUCT						PERCENT OF PRIVATE PLUS S&L SAVINGS
	TOTAL	PRIVATE	PERSONAL	CORPORATE	STATE & LOCAL	FEDERAL	FEDERAL
1947	11.29	4.61	2.43	2.18	0.47	6.20	122.11
1948	12.36	8.83	4.65	4.17	0.06	3.48	39.12
1949	5.86	7.28	3.16	4.11	-0.31	-1.12	-16.00
1950	10.32	7.28	4.53	2.75	-0.46	3.50	51.35
1951	9.79	7.79	5.29	2.50	-0.15	2.14	28.05
1952	6.84	8.03	5.45	2.57	-0.01	-1.17	-14.63
1953	5.60	7.67	5.51	2.15	0.04	-2.11	-27.32
1954	5.45	7.59	5.08	2.51	-0.33	-1.81	-24.88
1955	8.96	8.10	4.50	3.60	-0.35	1.21	15.61
1956	9.71	8.36	5.57	2.79	-0.23	1.58	19.49
1957	8.33	8.10	5.54	2.56	-0.34	0.57	7.30
1958	4.72	7.82	5.80	2.02	-0.58	-2.53	-34.90
1959	7.53	7.89	4.77	3.11	-0.10	-0.26	-3.30
1960	7.57	6.89	4.27	2.62	0.01	0.66	9.55
1961	6.54	7.43	4.82	2.61	-0.08	-0.81	-11.07
1962	7.31	8.04	4.51	3.53	0.09	-0.82	-10.12
1963	7.88	7.74	4.01	3.74	0.08	0.05	0.60
1964	8.75	9.13	5.05	4.08	0.17	-0.56	-6.01
1965	10.10	10.02	5.30	4.72	0.00	0.08	0.83
1966	9.59	9.77	5.17	4.60	0.07	-0.26	-2.61
1967	8.15	10.09	6.04	4.05	-0.14	-1.80	-18.06
1968	7.98	8.72	5.23	3.49	0.01	-0.75	-8.64
1969	8.52	7.37	4.70	2.67	0.17	0.98	12.94
1970	6.63	7.80	6.17	1.63	0.21	-1.37	-17.17
1971	6.52	8.50	6.18	2.32	0.26	-2.24	-25.60
1972	7.40	7.70	4.87	2.83	1.25	-1.56	-17.40
1973	9.84	9.20	6.53	2.67	1.11	-0.46	-4.48
1974	7.23	7.59	6.56	1.03	0.52	-0.89	-10.94
1975	4.29	8.88	6.78	2.09	0.39	-4.98	-53.77
1976	5.37	7.74	5.35	2.39	1.07	-3.44	-39.04
1977	6.27	7.34	4.30	3.03	1.63	-2.69	-30.04
1978	6.93	6.94	3.95	2.99	1.50	-1.51	-17.89
1979	7.28	6.72	3.99	2.73	1.24	-0.69	-8.62
1980	4.85	6.23	4.33	1.89	1.24	-2.62	-35.03
1981	5.04	6.00	4.10	1.90	1.40	-2.37	-31.98
	FIVE YEAR AVERAGES						
1951-1955	7.33	7.83	5.17	2.67	-0.16	-0.35	-4.64
1956-1960	7.57	7.81	5.19	2.62	-0.25	0.01	-0.37
1961-1965	8.11	8.47	4.74	3.73	0.05	-0.41	-5.15
1966-1970	8.17	8.75	5.46	3.29	0.06	-0.64	-6.71
1971-1975	7.05	8.37	6.18	2.19	0.71	-2.03	-22.44
1976-1980	6.14	6.99	4.38	2.61	1.34	-2.19	-26.13

Budget Deficits in Relation to GNP*



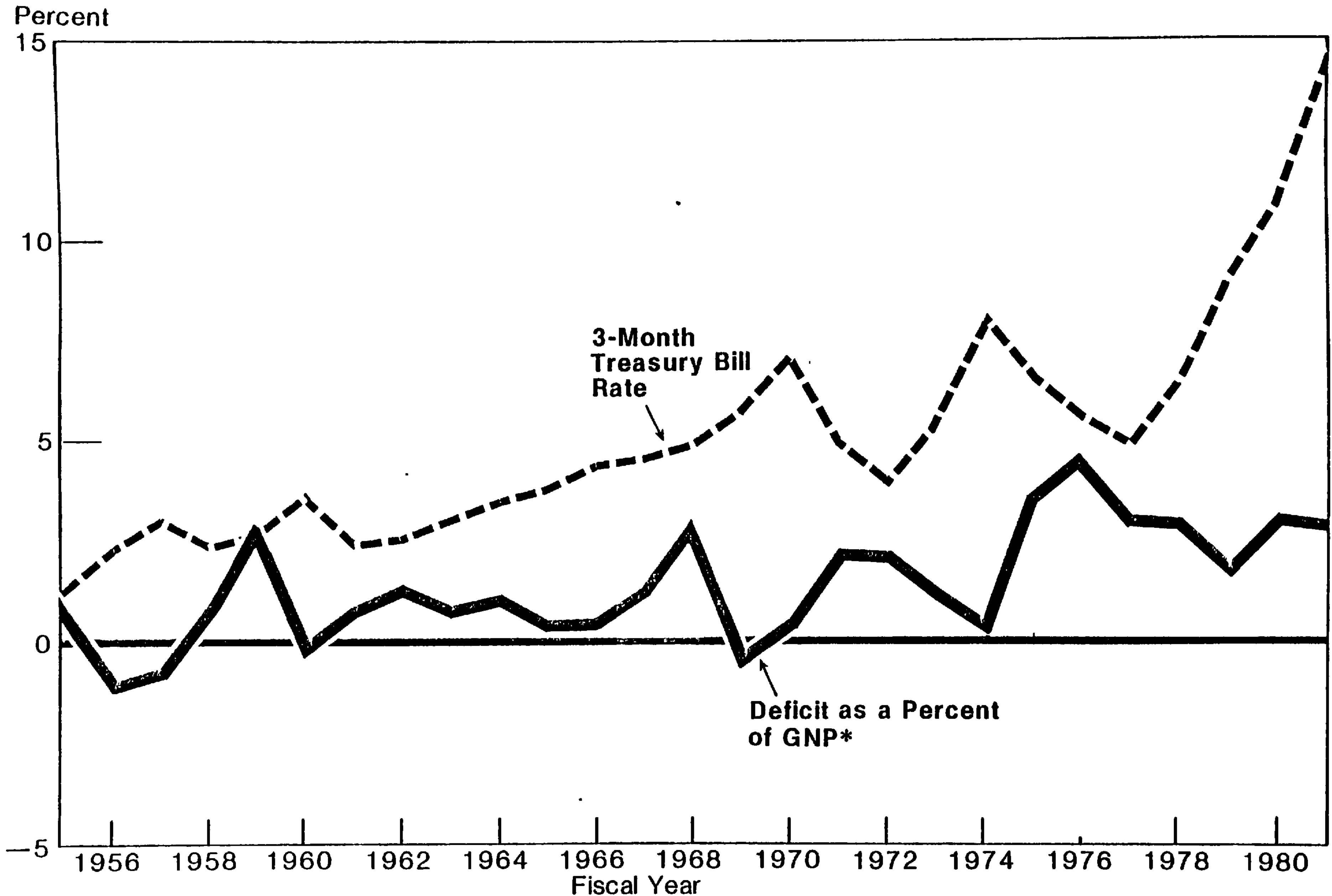
* On and off budget as percent of fiscal year GNP.

Budget Deficits in Relation to GNP

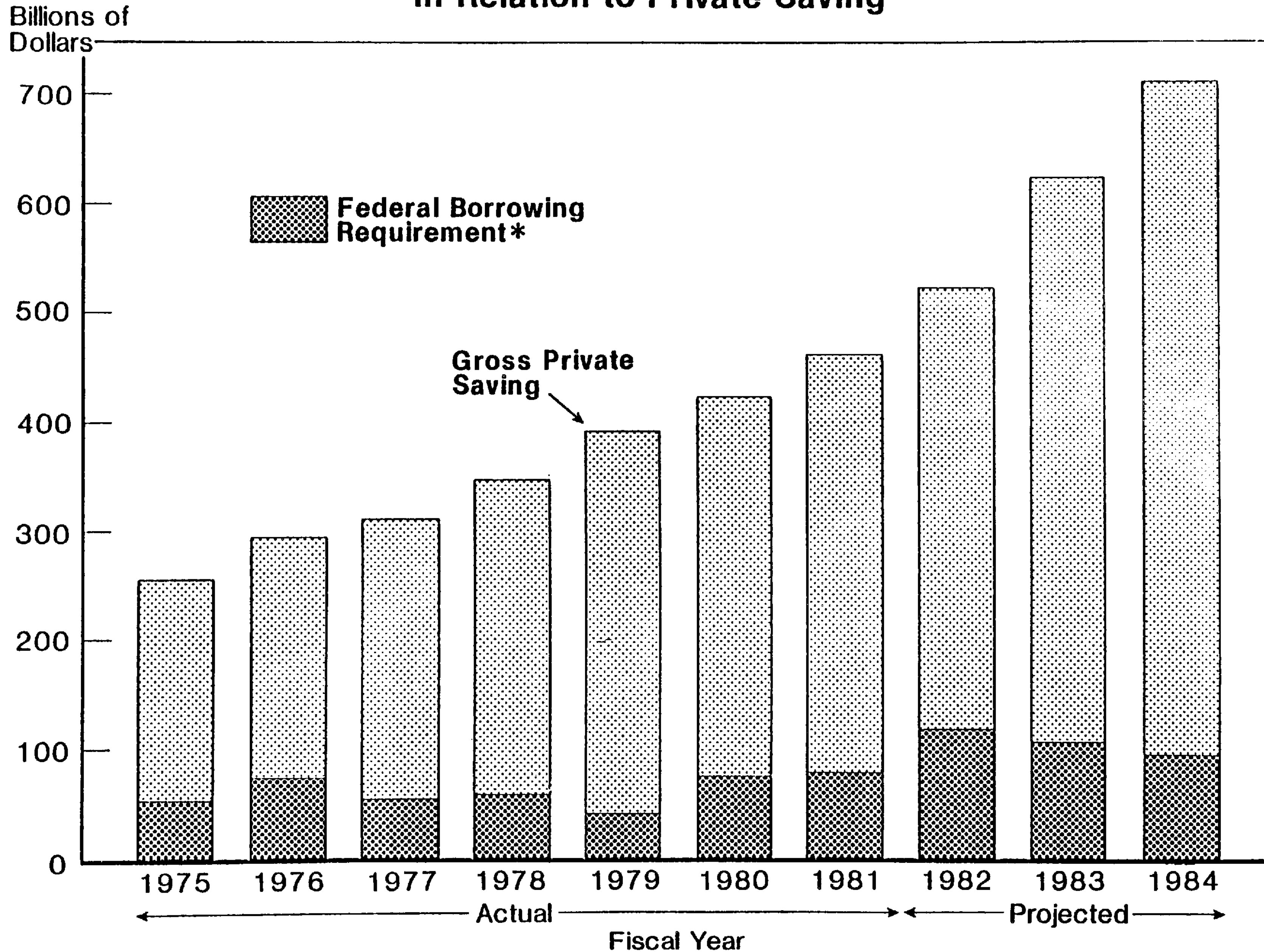
Fiscal Year		Deficits (Bil. of dols.)	Percent of GNP
1975		-53.2	-3.6
1976		-73.7	-4.5
1977		-53.6	-2.9
1978		-59.2	-2.8
1979		-40.2	-1.7
1980		-73.8	-2.9
1981	actual	-78.9	-2.8
1982	projected	-118.3	-3.8
1983		-107.2	-3.1
1984		-97.2	-2.6
1985		-82.8	-2.0
1986		-77.0	-1.7
1987		-62.5	-1.3

Note: Figures include off-budget entities.

3/23/82



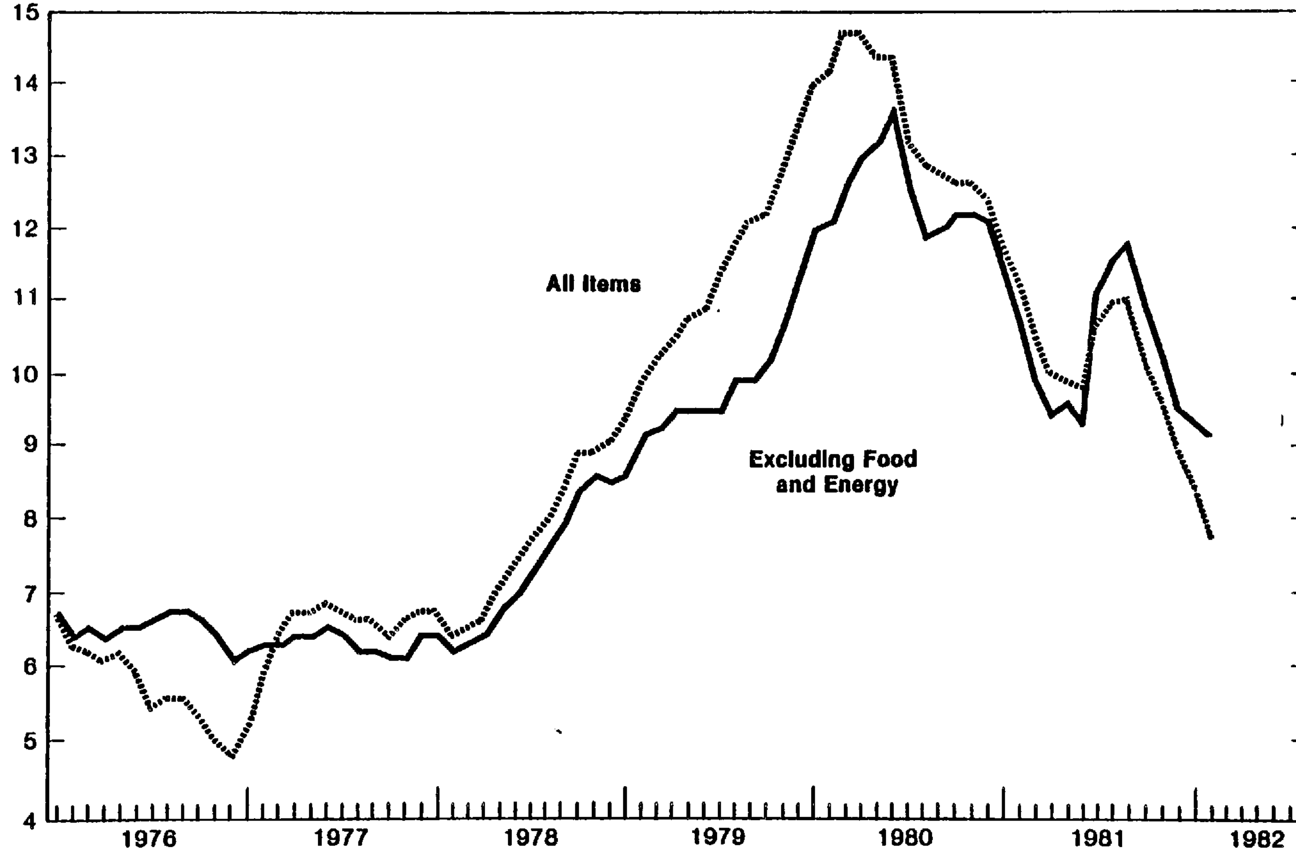
* Federal surplus or deficit includes off-budget items. Points below zero line represent surplus as percent of GNP, points above line a deficit.

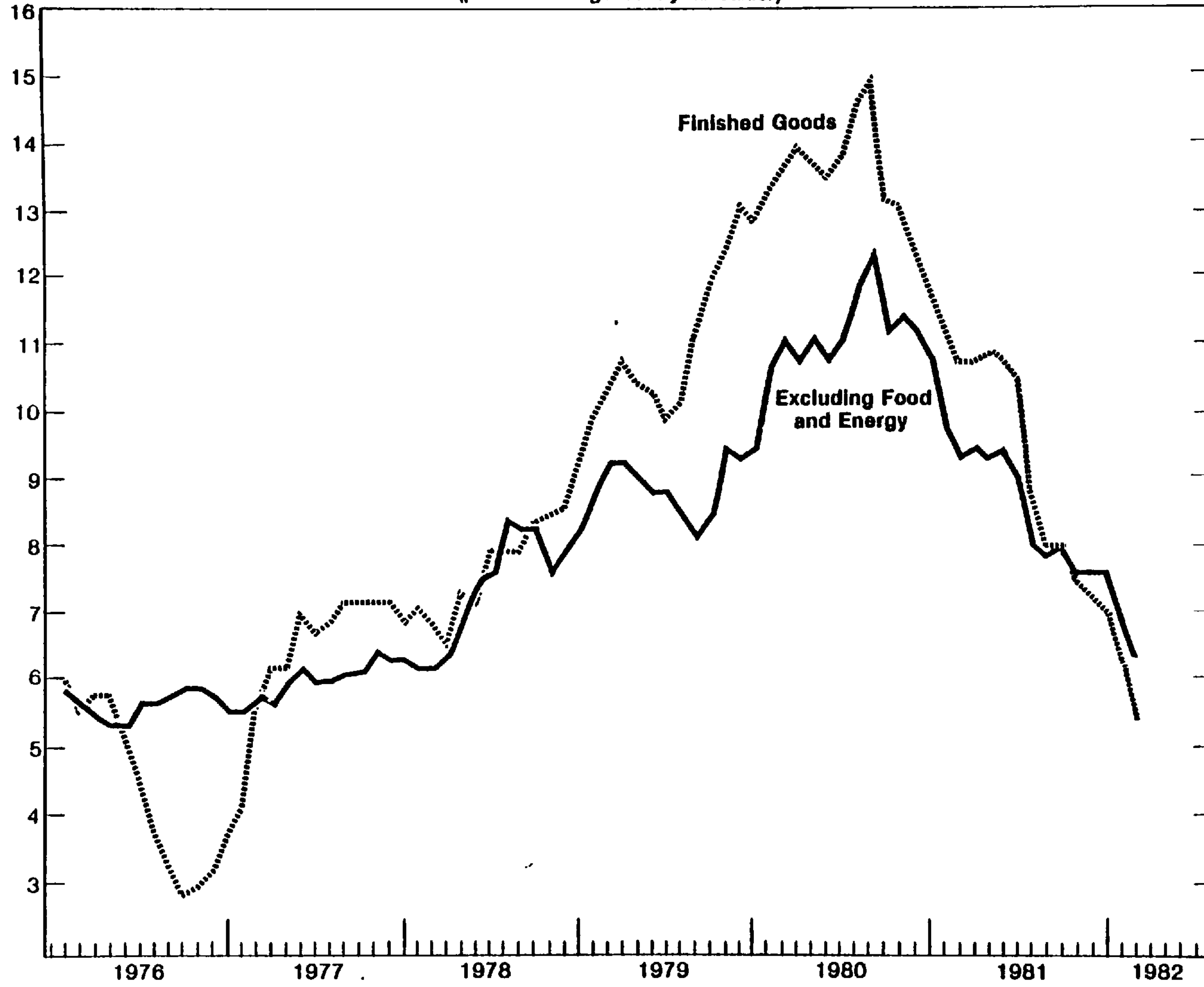

Projected Borrowing Requirement
in Relation to Private Saving
Billions of Dollars
700
600
500
400
300
200
100
0
Federal Borrowing Requirement*
Gross Private Saving
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
Actual
Projected
Fiscal Year
* Total budget deficit including off-budget entities.
Note: Saving flows do not reflect surpluses of state and local governments or inflows from abroad.
March 24, 1982

Projected Borrowing Requirement in Relation to Private Saving

Fiscal year		Gross private saving	Federal deficit including off-budget	Deficit as share of saving
		(---billions of dollars---)		(percent)
1975		253.4	-53.2	-21.0
1976		295.6	-73.7	-24.9
1977		309.8	-53.6	-17.3
1978		347.4	-59.2	-17.0
1979		392.2	-40.2	-10.2
1980		423.0	-73.8	-17.4
1981	actual	462.3	-78.9	-17.1
1982	projected	523	-118.3	-22.6
1983		624	-107.2	-17.2
1984		712	-97.2	-13.7

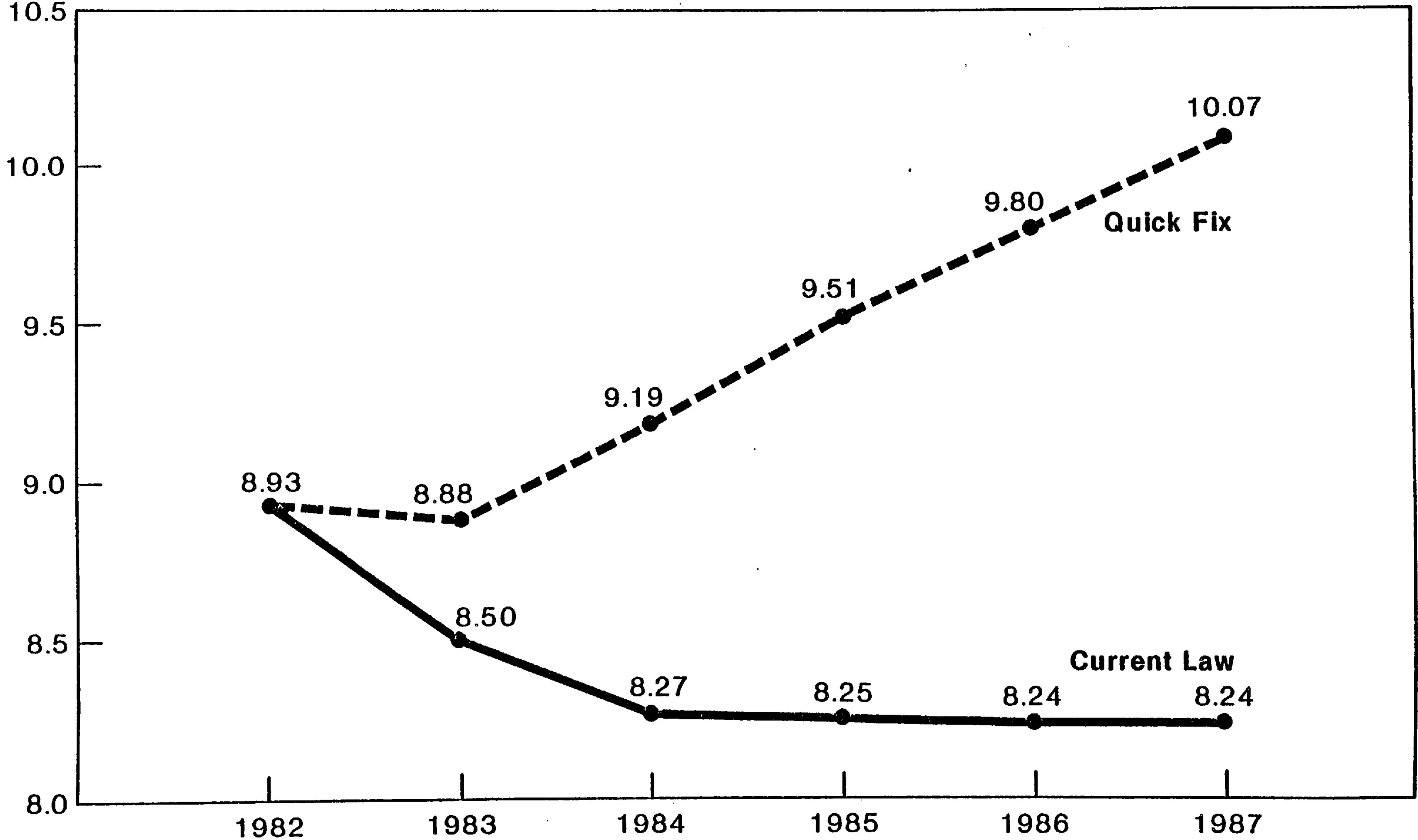
3/23/82


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

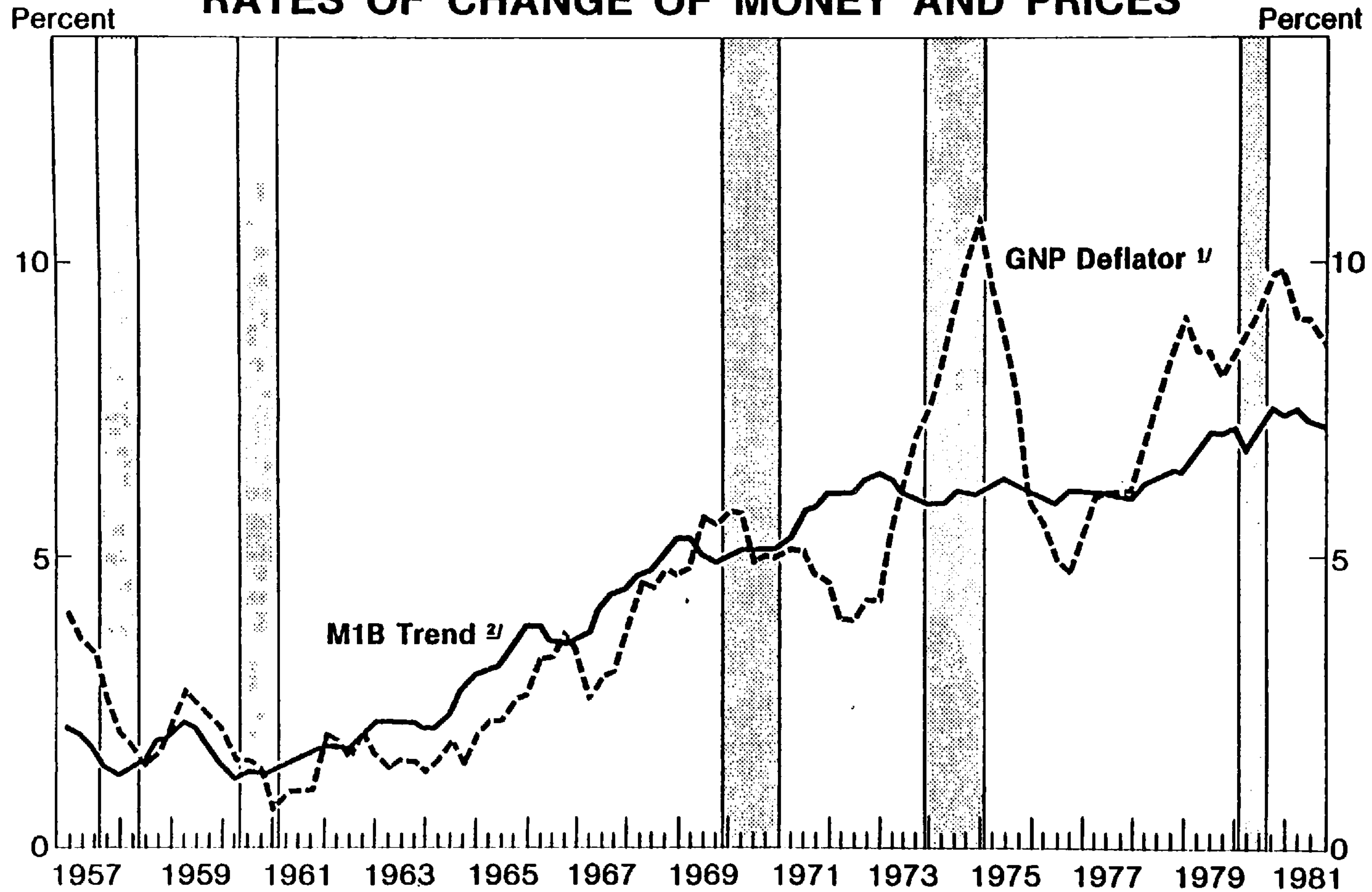


Producer Prices
(percent change from year earlier)
percent
16
15
14
13
12
11
10
9
8
7
6
5
4
3
Finished Goods
Excluding Food and Energy
1976
1977
1978
1979
1980
1981
1982

Current Law Tax Reduction vs. Quick Fix Alternative

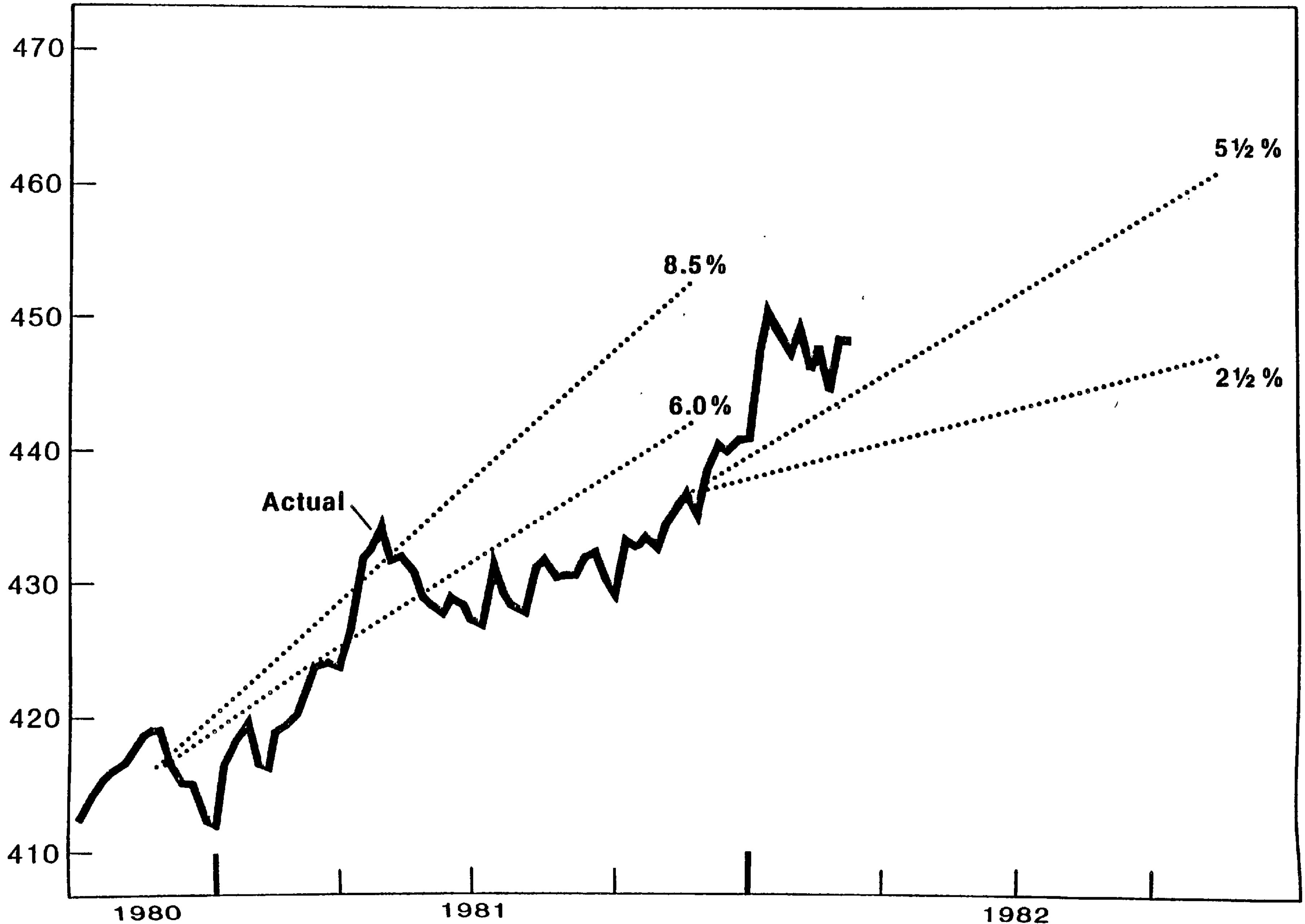


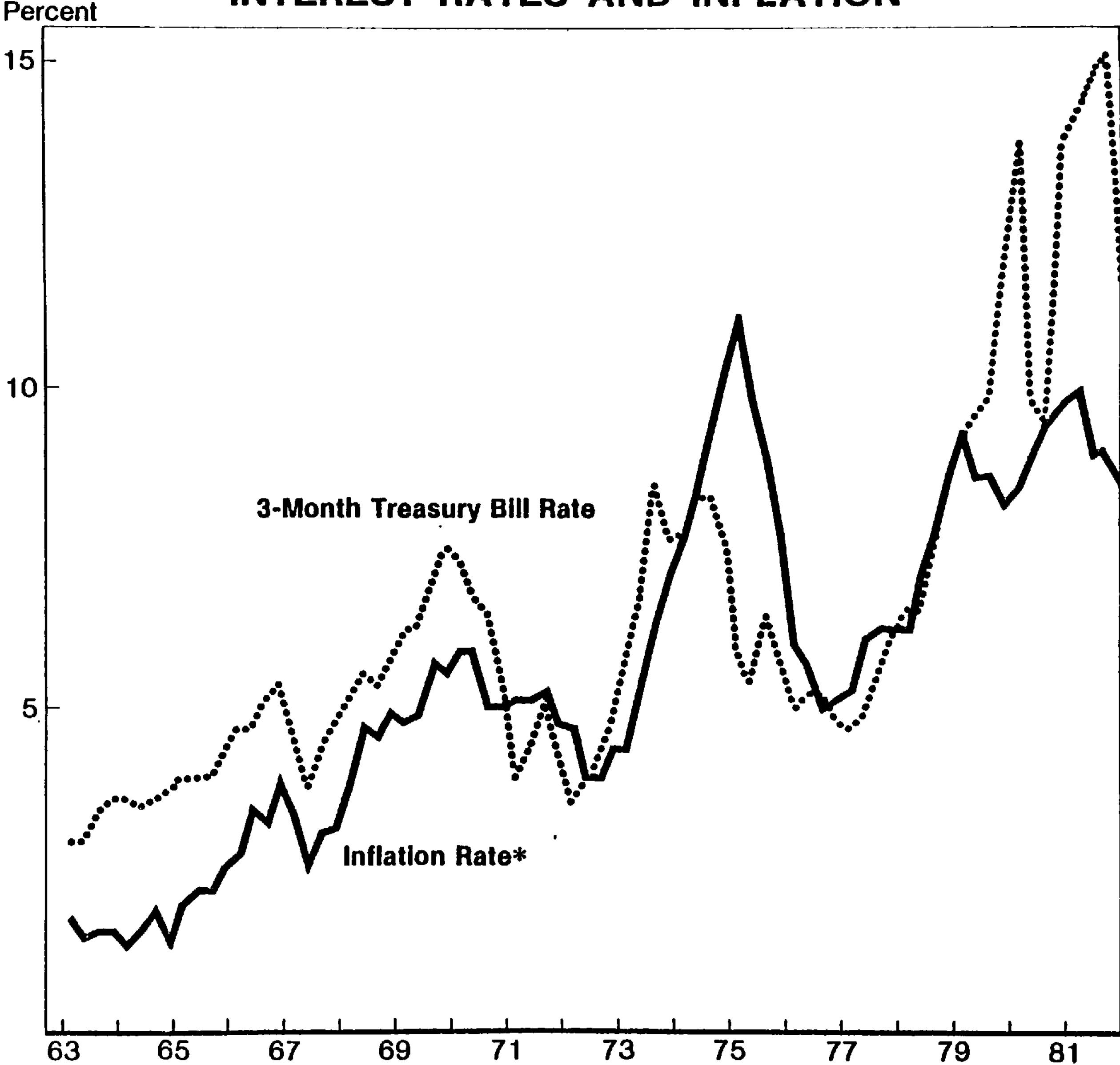
Quick Fix alternative leaves the July 1, 1982 tax rate reduction in place, but cancels the July 1, 1983 tax rate reduction and indexing.

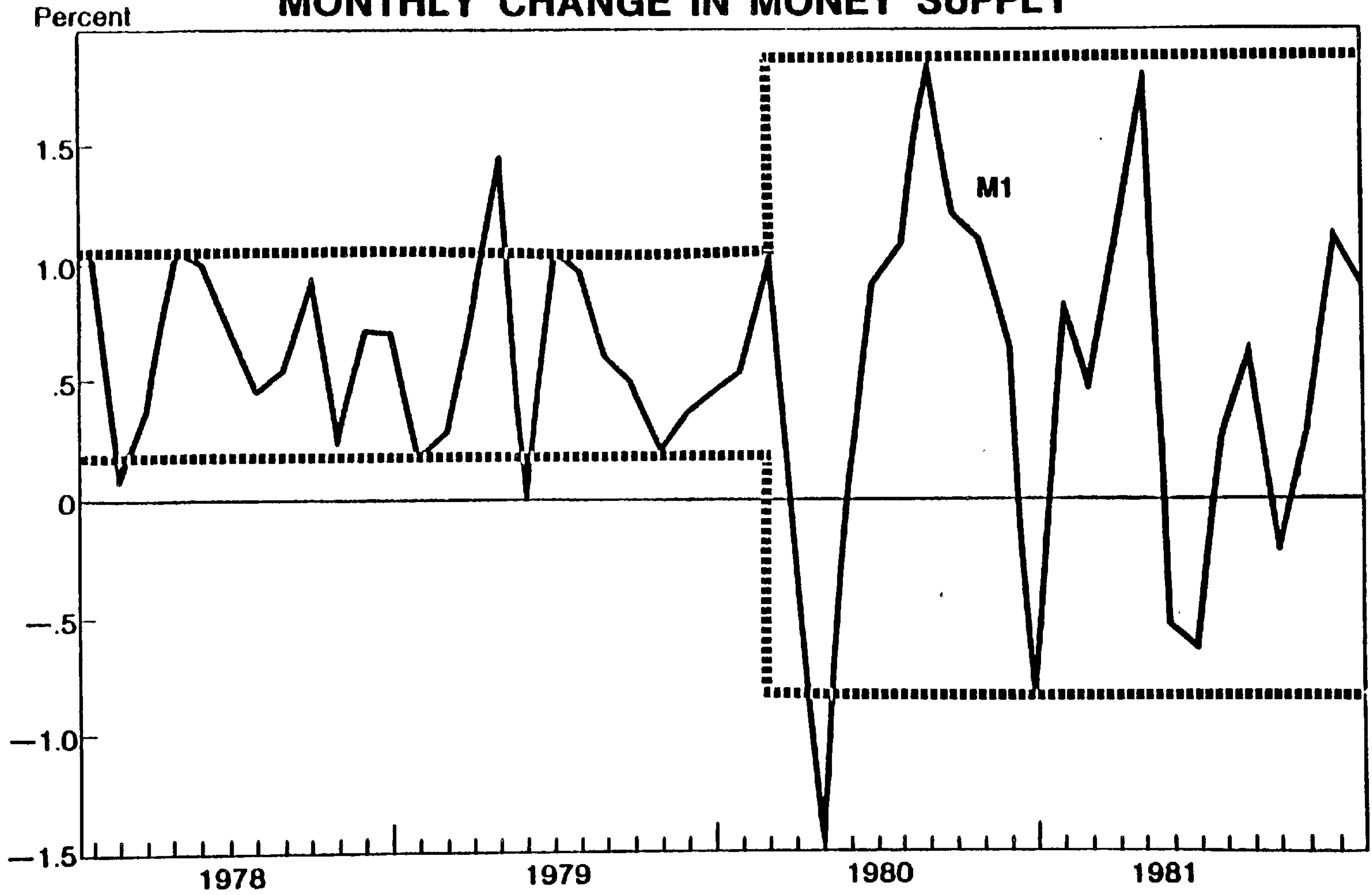


1/ Four-quarter rate of change;
2/ Twenty-quarter rate of change; data prior to 1st quarter 1964 are M1.
Latest data plotted: 4th quarter

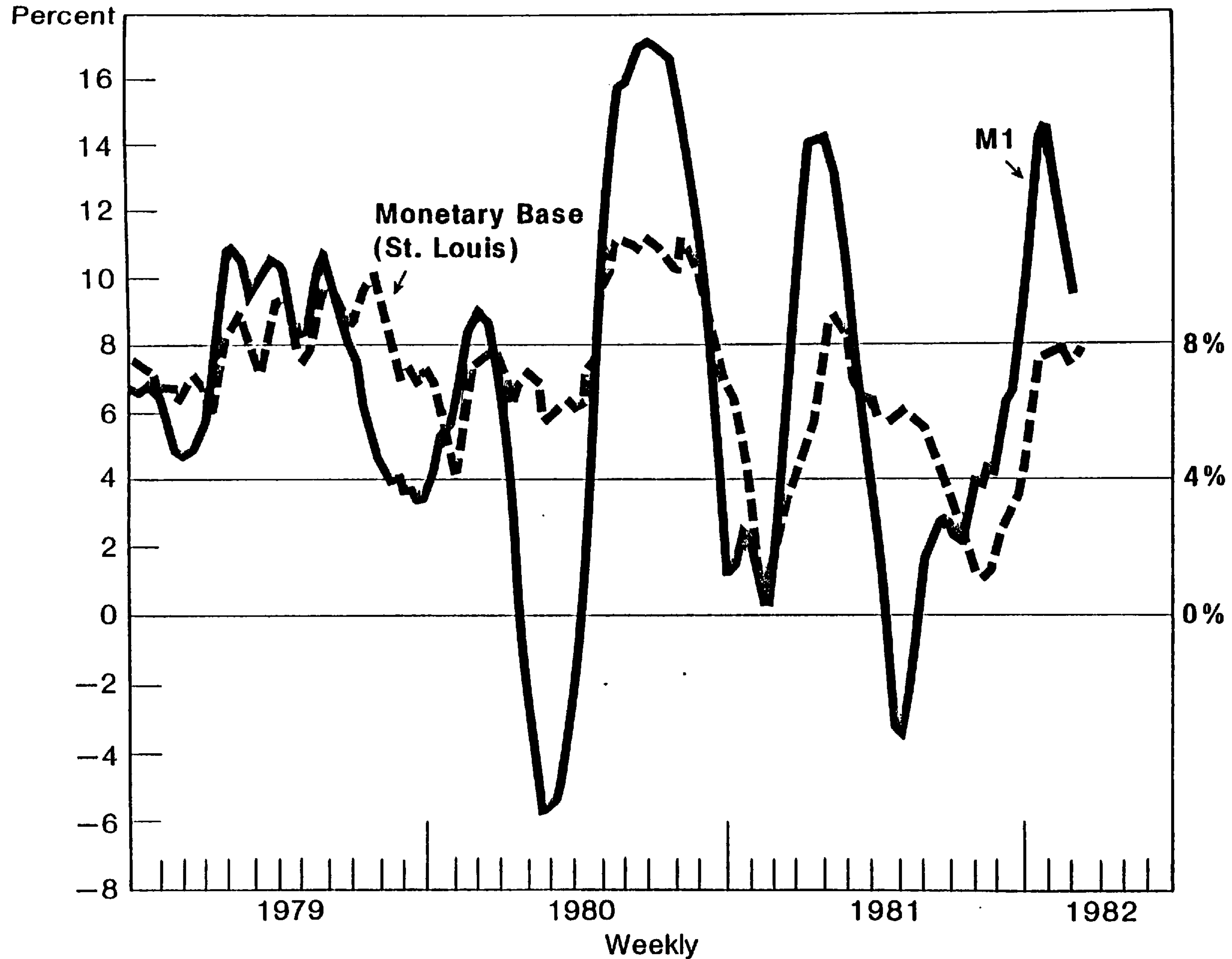
January 27, 1982-A164


M1 VERSUS TARGET RANGE*
470
460
450
440
430
420
410
8.5%
6.0%
5½ %
2½ %
Actual
1980
1981
1982
*Weekly Averages-Seasonally Adjusted


INTEREST RATES AND INFLATION
Percent
15
10
5
3-Month Treasury Bill Rate
Inflation Rate*
63
65
67
69
71
73
75
77
79
81
* Growth from year earlier in GNP deflator.
Plotted quarterly.
January 27, 1982 A169

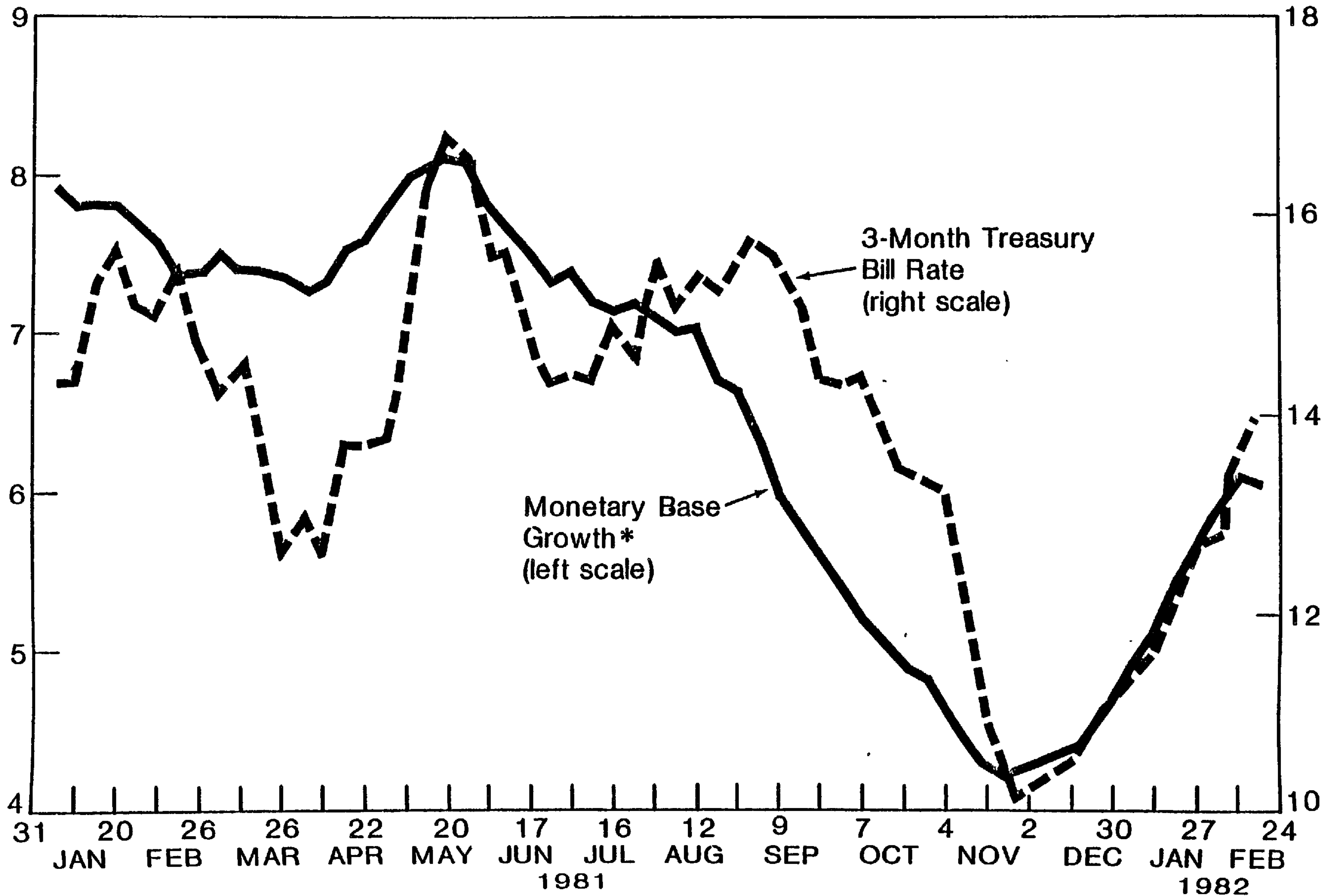

MONTHLY CHANGE IN MONEY SUPPLY
Percent
1.5
1.0
.5
0
—.5
—1.0
—1.5
M1
1978
1979
1980
1981

Quarterly Rates of Growth of Monetary Base and the Money Supply (M1)*

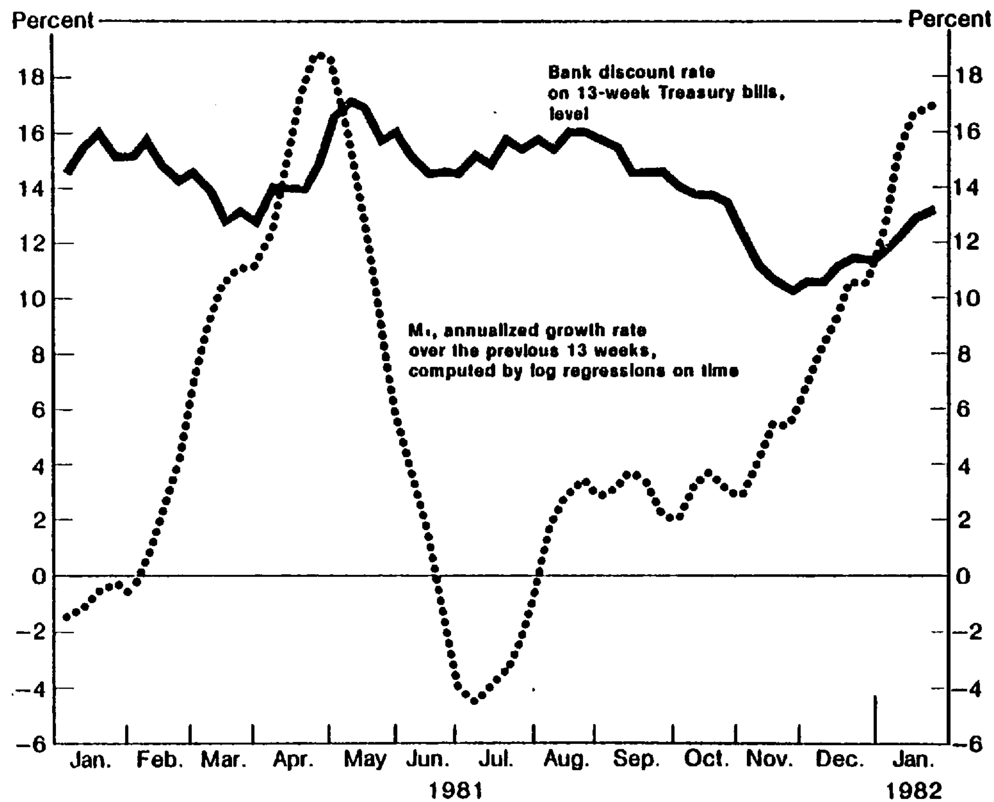


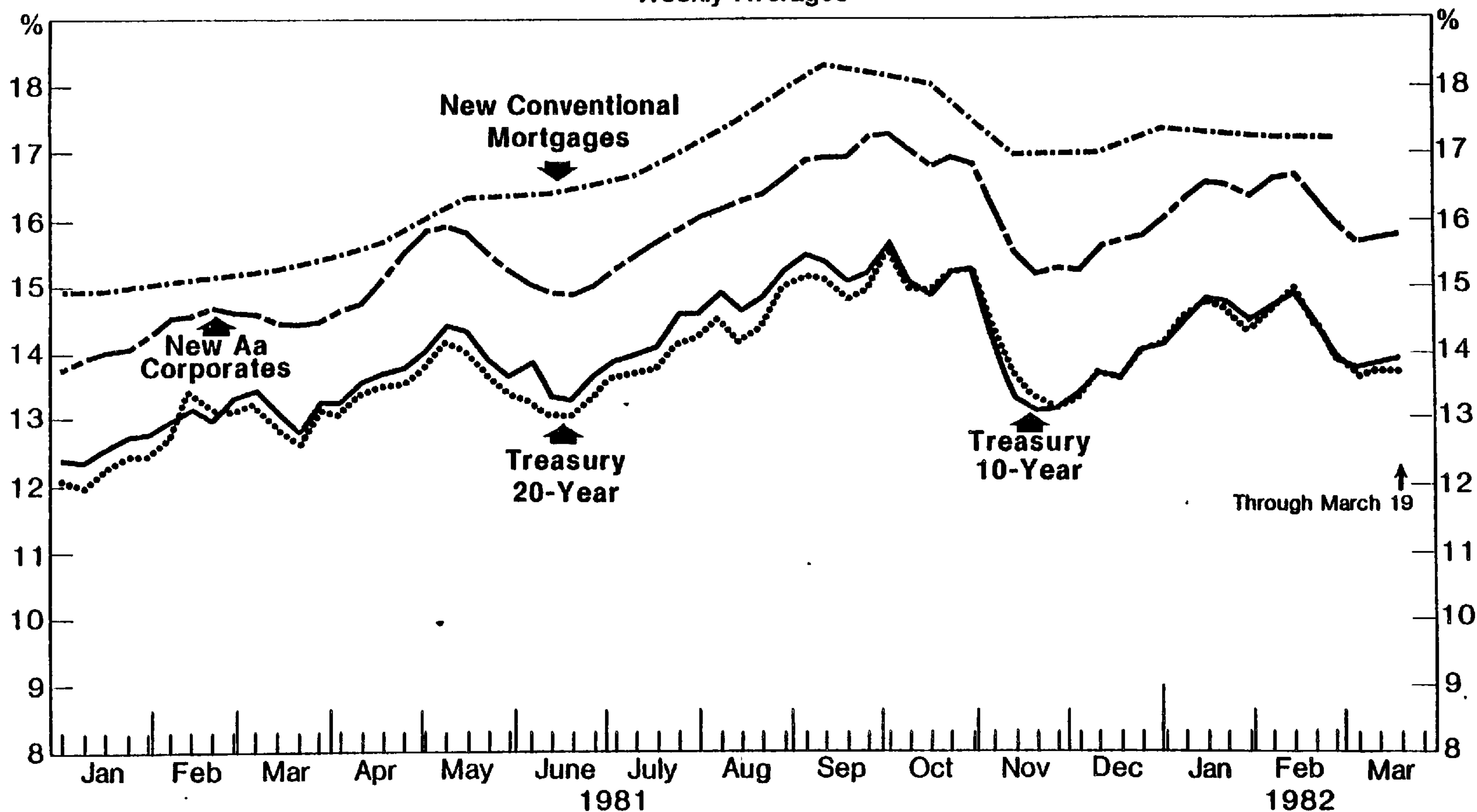
*Quarterly growth rates based on four-week averages compared with four-week averages thirteen weeks earlier, at annual rates. Latest week plotted: March 3 for M1, March 10 for monetary base.

Monetary Base Growth vs. 3-Month T-Bill



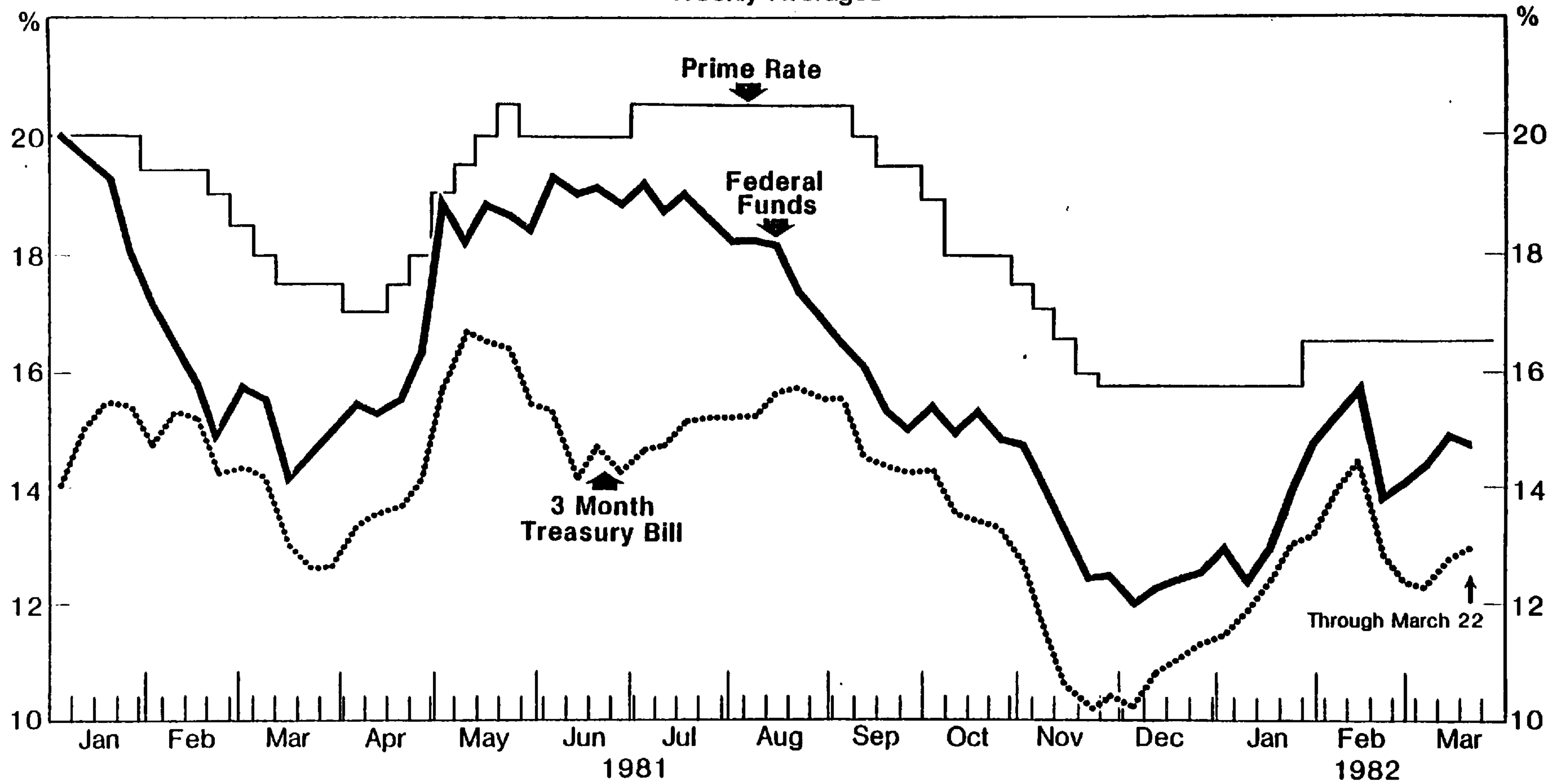
*52 Week Growth on 4-Week Moving Averages


THE THREE-MONTH TREASURY BILL RATE AND GROWTH OF M1
Percent
Percent
18
16
14
12
10
8
6
4
2
0
−2
−4
−6
Bank discount rate
on 13-week Treasury bills,
level
M1, annualized growth rate
over the previous 13 weeks,
computed by log regressions on time
Jan.
Feb.
Mar.
Apr.
May
Jun.
Jul.
Aug.
Sep.
Oct.
Nov.
Dec.
Jan.
1981
1982


INTERMEDIATE AND LONG MARKET RATES
Weekly Averages
%
18
17
16
15
14
13
12
11
10
9
8
New Conventional
Mortgages
New Aa
Corporates
Treasury
20-Year
Treasury
10-Year
Through March 19
Jan
Feb
Mar
Apr
May
June
July
Aug
Sep
Oct
Nov
Dec
Jan
Feb
Mar
1981
1982
Note: Mortgage data plotted monthly
Office of the Secretary of the Treasury
Office of Government Financing
March 24, 1982

SHORT TERM INTEREST RATES

Weekly Averages



Office of the Secretary of the Treasury
Office of Government Financing

March 24, 1982

TREASURY NEWS

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

FOR IMMEDIATE RELEASE March 24, 1982

RESULTS OF AUCTION OF 4-YEAR NOTES

The Department of the Treasury has accepted $ 3,753 million of $ 8,297 million of tenders received from the public for the 4-year notes, Series G-1986, auctioned today. The notes will be issued March 31, 1982, and mature March 31, 1986.

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

	Bids	Prices
Lowest yield	14.02%	99.940
Highest yield	14.08%	99.762
Average yield	14.05%	99.851

Tenders at the high yield were allotted 13%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

	Received	Accepted
Boston	$ 33,603	$ 25,303
New York	6,650,338	3,162,879
Philadelphia	26,000	25,000
Cleveland	65,045	49,695
Richmond	66,311	24,701
Atlanta	48,525	40,829
Chicago	914,485	194,060
St. Louis	71,459	63,219
Minneapolis	14,982	13,645
Kansas City	43,574	42,074
Dallas	20,999	18,999
San Francisco	337,960	89,535
Treasury	3,350	3,348
Totals	$8,296,631	$3,753,287

The $3,753 million of accepted tenders includes $ 722 million of noncompetitive tenders and $2,675 million of competitive tenders from private investors. It also includes $356 million of tenders at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities in exchange for maturing securities.

In addition to the $ 3,753 million of tenders accepted in the auction process, $288 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 $144 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE
March 25, 1982

Contact: Charles Powers
566-2041

Statement by Donald T. Regan
Secretary of the Treasury
Safe Harbor Leasing

There has been much debate about the safe harbor leasing provision of the Economic Recovery Tax Act of 1981. In order to enhance the discussion and encourage informed review of this important issue, we are releasing preliminary information on total 1981 safe harbor leasing activity. Our information is based on a representative sample of 2000 leases. When a larger sample has been analysed, additional information will be released.

Overall, our analysis indicates that the value of leased property in 1981 totaled $19.3 billion, very close to the figure upon which we based our initial revenue estimates. In addition, most of the tax benefits from leased property, about 84 percent, go to the lessee, while 15 percent is retained by lessors with the remaining one percent covering transaction costs to third parties.

Over 85 percent of the dollar value of all leased property was involved in transactions in excess of $10 million. More than 60 percent of the number of actual lease transactions, however involved less than $100,000 of property, and nearly 95 percent involved less than $1 million of property. Transaction costs for small lease arrangements appear to be no larger, relative to the size of the transactions, than they are for large lease transactions. These facts indicate that there are no real barriers to leasing by small companies.

Finally, companies in mining, oil and gas drilling, lumber and paper, chemicals, airlines, primary metals, motor vehicles, railroads, shipping and utilities were major lessees. This list includes most of those industries that have been considered "distressed."

Safe harbor leasing is a significant element in this Administration's effort to increase growth and productivity in the economy and provide jobs. It is a realistic attempt to provide equal incentives to invest to all firms. If our further study indicates the need, we will propose modifications in the existing safe harbor leasing rules.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE March 26, 1982

TREASURY OFFERS $8,000 MILLION OF 20 -DAY CASH MANAGEMENT BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $8,000 million of 20 -day Treasury bills to be issued April 2, 1982, representing an additional amount of bills dated April 23, 1981, maturing April 22, 1982 (CUSIP No. 912793 7G 5).

Competitive tenders will be received at all Federal Reserve Banks and Branches up to 1:30 p.m., Eastern Standard time, Tuesday, March 30, 1982. 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 three decimals, e.g., 97.920. 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 Friday, April 2, 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 March 29, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 4,701 million of 13-week bills and for $4,703 million of 26-week bills, both to be issued on April 1, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 1, 1982			:	26-week bills maturing September 30, 1982		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.627	13.344%	14.00%	:	93.320 a/	13.213%	14.36%
Low	96.603	13.439%	14.10%	:	93.296	13.261%	14.41%
Average	96.613	13.399%	14.06%	:	93.305	13.243% 2/	14.39%

a/ Excepting 3 tenders totaling $3,040,000.

Tenders at the low price for the 13-week bills were allotted 16%.
Tenders at the low price for the 26-week bills were allotted 18%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 53,455	$ 42,775	:	$ 78,940	$ 48,300
New York	9,185,525	3,666,525	:	8,709,275	3,670,840
Philadelphia	64,585	64,070	:	23,255	22,435
Cleveland	54,210	36,510	:	123,085	67,855
Richmond	36,860	35,860	:	93,175	45,535
Atlanta	51,855	46,460	:	88,725	45,725
Chicago	817,655	370,390	:	733,765	179,815
St. Louis	39,960	37,360	:	39,015	33,015
Minneapolis	11,750	11,750	:	18,795	15,235
Kansas City	46,195	45,865	:	44,940	43,695
Dallas	28,370	28,370	:	23,960	23,960
San Francisco	784,045	132,265	:	888,950	258,450
Treasury	183,075	183,075	:	247,875	247,875
TOTALS	$11,357,540	$4,701,275	:	$11,113,755	$4,702,735
Type					
Competitive	$ 9,493,200	$2,836,935	:	$ 8,695,915	$2,284,895
Noncompetitive	897,150	897,150	:	864,640	864,640
Subtotal, Public	$10,390,350	$3,734,085	:	$ 9,560,555	$3,149,535
Federal Reserve	726,290	726,290	:	700,000	700,000
Foreign Official Institutions	240,900	240,900	:	853,200	853,200
TOTALS	$11,357,540	$4,701,275	:	$11,113,755	$4,702,735

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.735%.

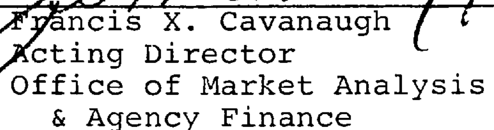
R-702

FOR IMMEDIATE RELEASE MARCH 29, 1982

The Treasury announced today that the 2-1/2 year Treasury yield curve rate for the five business days ending March 29, 1982, averaged 14.30% rounded to the nearest five basis points. Ceiling rates based on this rate will be in effect from Tuesday, March 30, 1982 through Monday April 12, 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

ADDRESS BY BERYL W. SPRINKEL, UNDER SECRETARY FOR MONETARY AFFAIRS, BEFORE THE TWENTY-THIRD ANNUAL MEETING OF THE INTER-AMERICAN DEVELOPMENT BANK, CARTAGENA, COLOMBIA

March 30, 1982

Mr. Chairman, Mr. President, fellow Governors, ladies and gentlemen, it is a great honor and a pleasure for me to be here today to represent the United States at this twenty-third annual meeting of the Inter-American Development Bank. Secretary Regan has asked me to convey his regards and best wishes for a successful meeting.

I would like to offer my thanks to the government and people of Colombia for the warm welcome and generous hospitality they have extended to me and all the members of the U.S. delegation. It has been a real pleasure to visit this beautiful and historic city of Cartagena. This year's meeting has provided me with a wonderful opportunity to meet with my colleagues from Latin America, and to learn more about the Inter-American Development Bank and the important role it plays in the hemisphere.

The role of the Bank in furthering the growth and development of Latin America and the Caribbean has been highlighted at this year's meeting by the ongoing discussions of the proposed replenishment of IDB resources. In this context, I would like to take this opportunity to describe for you today the framework within which my government will be formulating its final position regarding participation in the proposed sixth replenishment. I would hope that this will help to maintain the momentum of the negotiations, and aid others in formulating their positions, so that fruitful discussions can continue at the next session in Berlin in July.

The survival and growth of the Inter-American Development Bank since its creation more than twenty years ago adequately testifies to the importance of the institution and the mutual benefits derived by borrowers and donors alike. I do not need to remind you of the special importance of Latin America and the Caribbean to my government. President Reagan's recent address to the Organization of American States outlined a bold new initiative designed to deal with the special problems and critical needs of the countries of the Caribbean Basin.

This Caribbean Basin Initiative is a multi-nation plan to promote economic growth in the Caribbean and Central America, and was developed in cooperation with Canada, Mexico, Venezuela, and more recently, Colombia. We are now seeking

Congressional approval of the major elements of our contribution to the Caribbean Basin, which include first, a one-way free trade area; second, special tax incentives for investment; and third, increased financial assistance.

The IDB itself has undertaken a key role in this intiative -- to coordinate the formulation of economic development plans for the countries of Central America. We would like to commend the IDB for its willingness to undertake this program. All of these efforts are strongly supported by the United States as positive measures to address immediate, specific needs which are unique to countries of this particular region.

But, the special programs I have mentioned are just that -- "special." They can only be complementary to the long-term, on-going work of the Inter-American Development Bank. The best hope for sustained growth and prosperity in the region lies in the hands of the countries themselves. The multilateral development banks, in particular the IDB, can play a key role in ecnouraging growth and prosperity.

It was within this context of better defining the role of the multilateral development banks that we undertook just over a year ago to assess U.S. participation in the MDBs. Many of you now have read the recently completed study. The central conclusions of that study are that the multilateral development banks are effective instruments for promoting a healthy and growing world economy, and that U.S. participation in the MDBs has served important U.S. economic, political, and humanitarian interests.

At the same time, the Assessment recognizes that the effectiveness of the multilateral development banks can be improved by enhancing their role as financial catalysts, and as providers of sound economic policy advice, through insistence on appropriate macro economic and sector policies. The Assessment also recognizes the considerable scope for increased financial leverage of the capital resources of all the banks, in particular the IDB, whose financial strength and degree of recognition in capital markets is consistently reflected in its Triple-A bond ratings.

We will be seeking, within the context of the proposed sixth replenishment of IDB resources, to implement many of the recommendations of the Assessment. We believe these recommendations are critical to the future effectiveness and viability of the IDB; and the extent to which they are implemented will play a major role in determining the nature of U.S. participation in the institution.

We are aware of the fact that the IDB is a multilateral institution, and that the influence of any single shareholder is limited. But, I believe we can arrive at a consensus which supports our objectives, and that, together we can move forward in a deliberate and well conceived fashion. Our major goal is, after all, to make the IDB an even more effective institution; this is a goal which we all share.

Turning now to the specifics of our program, there are three basic objectives which we are pursuing. These objectives are: greater private sector involvement; a shift in the allocation of resources towards those countries which are most in need, and which demonstrate a desire and ability to make the best use of those resources; and, while bearing in mind the need to maintain the strong financial reputation of the IDB, an increase in the financial leverage of contributions and subscriptions to the IDB, to reflect the strengthened position in international financial markets of some of the IDB's major borrowers.

With respect to the first of these objectives -- greater private sector involvement -- let me emphasize that our attitude toward international policy questions generally is consistent with our own internal economic policy. Internationally, as well as domestically, we are committed to the free market system. We are convinced that economic growth and productivity can be advanced most effectively, both at home and abroad, through greater reliance on private economic activity.

In terms of the IDB, we anticipate an increased emphasis on its role as a catalyst for private investment flows. Taxpayers in the donor countries should not be expected to shoulder burdens which can be accommodated by the free play of market incentives. To this end the IDB can facilitate attractive investment environments in their borrower countries by:

-- encouraging free and open markets;

-- reducing barriers to private capital investment flows;

-- encouraging sound economic policies;

-- limiting the scope of government; and

-- helping those countries prepared to help themselves.

Private sector co-financing represents a significant source of potential private sector involvement in development. The IDB has already begun to tap this source, approving twenty "complementary" loans totalling $513 million in the period 1976 through 1981. This is a commendable effort, and we fully support the IDB's plans to expand its complementary financing program.

All of the multilateral development banks must recognize that public sources of development resources will remain strictly limited over the coming years, and steps must be taken to increase the flow of private co-financing. If co-financing is to come close to realizing its full potential, it must be shown to be in the best interests of the three participating parties -- the borrower, the private lender, and the IDB. The terms and flexibility of co-financing instruments will have to be made more attractive to the private lenders. The borrowers will need to realize that limited IDB funds can be blended with additional resources through private co-financing, and that such arrangements are a natural element of the evolutionary process of development assistance.

Discussion of the IDB's catalytic role brings me to our second major objective in the bank: the pursuit of well-formulated maturation and graduation policies. In the IDB in particular, where per capita incomes of borrowing member countries are relatively high, we will be encouraging an increasing reliance by its borrowers on hard window funds, thereby releasing scarce concessional funds for allocation among only the poorest countries.

We understand the substantial development needs of Latin America and the Caribbean. We are not convinced, however, that these needs can be financed only with concessional funds of the amount and on the terms currently provided by the Fund for Special Operations. While we are willing to consider some replenishment of resources to be provided on terms more concessional than in the IDB's capital window, these resources should be allocated only to the poorest countries of the region which cannot afford nor have adequate access to alternative sources of finance.

At the same time, in order that sufficient hard window funds can be made available to "maturing" IDB borrowers, the higher income borrowers must reduce their reliance on IDB capital, and turn increasingly to private markets in which they have already demonstrated their credit-worthiness.

I have already discussed the role of private co-financing in providing assistance to IDB borrowers. Such co-financing is a natural element of the maturation/graduation process which we foresee in the IDB. But, in order for this graduation/maturation policy to be successfully implemented, and in order to attract the private co-financing which is a part of that process, the IDB must link its loans and technical assistance to appropriate micro economic and sector policy advice, and to the pursuit by its borrowers of appropriate monetary and fiscal policies. On the micro-economic policy side, this advice should address:

-- reducing impediments to market determination of prices;

-- minimizing producer and consumer subsidies; and

-- eliminating bureaucratic constraints to a dynamic private sector.

On the macro-economic side, the IDB should, through its lending, support and facilitate the implementation of IMF programs where appropriate, and generally work to ensure that its projects are being carried out in an environment conducive to sustainable economic growth and development.

We are convinced that when such policies are introduced, and rigorously adhered to, the climate for both domestic and foreign private investment will significantly improve.

A third major objective we will be pursuing in the sixth replenishment is increased financial leverage of the IDB's capital resources. As the IDB prepares for another expansion of its resources, we believe it is imperative to question how great an increase is needed, given the considerable scope for further expansion of the Bank's financial leverage. The IDB is a mature financial institution with a proven track record in international credit markets. Given the obvious constraints on budgetary outlays from IDB donor countries in the eighties, and the continuing need for a significant IDB lending program, it is essential that use of IDB resources be maximized.

There are two specific areas in which we are focusing our attention: paid-in capital and usable callable capital. While I will leave the details to our representative in the replenishment negotiations, let me just make a few key points.

First, we believe there is considerable potential for expanding the Bank's lending program without requiring an unrealistic direct budgetary contribution from participating countries. Second, a key component of a successful maturation/graduation policy will be an increasing use of higher income borrowers' contributions and subscriptions as backing for IDB bonds. These countries already borrow considerable sums on their own in commercial markets, and there is no reason their paid-in and callable capital cannot be 100 percent usable by the bank in its borrowing operations. Third, as retained earnings provide for higher levels of accumulated reserves, the argument in favor of high proportions of paid-in capital becomes less convincing. Maintenance of a lending rate which fully covers all the Bank's costs and appropriate adjustments in amortization and grace periods will permit the IDB's existing paid-in capital and reserves to continue to generate further profits, thereby enhancing the equity cushion and preventing the decapitalization of the institution.

I have mentioned today the three goals which are the structural underpinnings of our approach to the proposed resource replenishment for the IDB. These goals were formulated in the context of a thorough assessment of all the multilateral development banks. We are pursuing these goals not because we believe the banks have done a bad job in the past, or because U.S. support for these institutions has weakened, but rather because we believe that the banks can do an even better job in the future, and because achievement of our goals and objectives will result in stronger, more effective institutions which can count on the support of both traditional and new donor countries.

In sum, we support continued growth in the IDB's lending program. We favor the concept of increasing reliance on non-traditional donors to help finance that lending program. Development assistance should support an evolutionary process in which funds are allocated to countries most in need, while those countries which already have access to alternative sources of finance rely less and less on development bank funds. Consistent with maintaining the financial integrity of the Bank and its financial maturity we expect the Bank to be able to better leverage subscriptions made by member governments. Development assistance should be seed money to encourage the adoption of appropriate economic policies which will result, in turn, in increased access to private markets.

The IDB itself has evolved over the previous twenty years so that it also can "mature" out of total dependence on donor country contributions to a reliance on its own ability to attract private resources. This is the future we foresee for the IDB, and we believe it is a promising one.

TREASURY NEWS

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For Release Upon Delivery
Expected at 10:00 a.m. EST

STATEMENT OF DAVID G. GLICKMAN
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE SUBCOMMITTEE ON
ENERGY AND AGRICULTURAL TAXATION
OF THE SENATE COMMITTEE ON FINANCE
MARCH 30, 1982

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to present the Treasury Department's views on S. 1819, a bill to amend the Internal Revenue Code with respect to the taxation of crude oil purchasing cooperatives. Under the bill, crude oil purchasing cooperatives would be treated in a manner similar to that accorded exempt farmers' cooperatives under section 521 of the Code. Consequently, unlike so-called "subchapter T" cooperatives which are taxable on all nonpatronage business, crude oil purchasing cooperatives would be able to claim deductions against income for amounts paid to patrons from nonpatronage sources, including income from business done with the United States and its agencies.

Treasury opposes enactment of S. 1819.

We were recently advised that this Committee is also considering S. 2151, a bill to amend the Code to add an additional item to the list of specially defined energy property. We have not had sufficient time to study the bill and comment on its provisions. However, we would be pleased to forward our comments for the record if the Chairman would permit us to do so.

R-704

Taxation of Cooperatives

In general, cooperatives governed by subchapter T of the Code are not subject to tax when operating on a cooperative basis with patrons. The advantage of operating on a cooperative basis is that it allows small businesses to form an association which may use its large size to obtain purchasing and marketing economies and efficiencies for the benefit of its patrons without incurring a corporate tax at the association level. The elimination of the corporate level tax is accomplished by permitting a deduction for distributions (or deemed distributions) from cooperatives to patrons which are based on the amount of business done with the patrons on a cooperative basis. Such distributions are includible in the income of the patron. Use of the cooperative form enables patrons to defer the recognition of income in patronage transactions. These benefits are not available with respect to transactions which are not carried out on a cooperative basis.

"Tax-exempt" farmers' cooperatives calculate their income in the same way as subchapter T cooperatives but, in addition, receive other significant tax benefits, including the ability to deduct from gross income dividends paid on capital stock and amounts paid to patrons with respect to earnings derived from business done with the United States Government or its agencies or (to a limited extent) from other nonpatronage sources.

Description of the Bill

S. 1819 is intended to provide crude oil purchasing cooperatives the same tax benefits as are available to farmers' cooperatives. In addition, the bill would grant to such organizations significant benefits not available to farmers' cooperatives.

S. 1819 would exempt from income tax crude oil purchasing cooperatives. The membership of such cooperatives must consist of independent refiners or subchapter T cooperatives and must be organized for the purpose of: (1) purchasing crude oil and reselling it to members, nonmember independent refiners and nonmember subchapter T cooperatives and turning back to them the proceeds of such resale less necessary expenses; (2) purchasing supplies and equipment for the use of members, nonmember independent refiners and nonmember subchapter T cooperatives and turning over such supplies and equipment to them at actual cost plus necessary expenses; (3) trading crude oil; (4) storing crude oil; and (5) insuring risks associated with any of the enumerated activities.

The bill describes necessary expenses as being the greater of 15 percent of the costs allocable to such activity or the amount demonstrated by the cooperative as being properly allocable to the costs of such activity.

Crude oil purchasing cooperatives under S. 1819 could operate in a manner which is far less restrictive than applied to farmers' cooperatives.

First, membership of farmers cooperatives is limited to farmers, fruit growers and like organizations. Membership in crude oil purchasing cooperatives is not limited in any respect since, in addition to independent refiners, any subchapter T cooperative may be a member. There is no requirement that the subchapter T cooperative members must be independent refiners.

Second, section 521 does not specifically authorize farmers' cooperatives to trade or store agricultural products, nor does it authorize the insurance of risks relating to such activities. S. 1819 does so with respect to activities of crude oil purchasing cooperatives. More importantly S. 1819 allows the oil purchasing cooperative to engage in "any other activity incidental to" the itemized purposes or "designed to increase the efficiency of the associations" in carrying out the itemized activities. This would appear to permit these organizations to engage in refining activities and to purchase and market refined products. It may also permit the cooperatives to construct and sell refining equipment.

Third, S. 1819 contains a "necessary expense" rule which would permit the cooperative to treat as a expense with respect to a patronage transaction 15 percent of costs allocable to an activity even when the actual cost attributable to the patronage activity is less. This would permit the cooperative to make a profit on cooperative transactions with patrons. Furthermore, this profit would not be subject to tax to the extent it is distributed to members as a dividend on capital stock. Neither section 521 farmers' cooperatives nor other cooperatives are granted such benefits.

Fourth, S. 1819 would increase the amount of business that can be done on a nonpatronage basis by crude oil purchasing cooperatives to 25 percent. Under section 521, farmers' cooperatives are limited in the amount of business they can do with nonpatrons to 15 percent of the value of all the cooperative's purchases.

Treasury Position

On March 27, 1981, this Subcommittee held hearings on tax incentives for independent refiners. One of the incentives then considered was a proposal to allow independent refiners to organize crude oil purchasing cooperatives. At that hearing the Treasury Department opposed adoption of the exempt cooperative proposal. Since that time we have studied the proposal in greater detail and have met with representatives of independent refiners. The Treasury Department remains strongly opposed to the enactment of S. 1819.

Statements submitted on March 27, 1981 on behalf of the American Petroleum Refiners Association and the Independent Refiners Association of America indicated that the rationale for the exempt cooperative proposal was: (1) to enable independent refiners to negotiate long-term oil supply contracts at a level equivalent to that of government-to-government negotiations (that is, it was felt that in dealing with foreign government oil marketing organizations, purchasing cooperatives would have greater bargaining leverage than an individual independent refiners); (2) to obtain broader access to financial markets; and (3) to avoid antitrust complications.

It has not been demonstrated that the achievement of the three avowed goals of this legislation can not be accomplished under current law in a variety of ways. Independent refiners can combine to attain these goals without incurring a corporate level tax through the use of the partnership form of operation, the corporate form (but with the additional cost of a seven-plus percent tax on intercorporate dividends) or as a subchapter T cooperative. Although the independent refiners contend that the partnership and corporate forms are deficient for a variety of reasons (a contention with which we disagree), subchapter T of the Code can clearly accommodate the three goals.

First, independent refiners can establish cooperatives to purchase crude oil from foreign suppliers under long-term contracts. Their larger size may assist them in dealing with foreign governments on a more advantageous basis. Second, the combined financial resources of the purchasing cooperatives may permit such organizations to obtain more favorable financing than they would if they seek to purchase oil independently. Third, whatever antitrust implications exist for subchapter T cooperatives presumably exist for crude oil purchasing cooperatives.

Since under subchapter T such cooperatives will not pay an income tax to the extent they deal with their members or patrons on a cost plus expenses basis it is not apparent why there is a need to amend the tax laws to provide tax exemption for crude oil purchasing cooperatives. Obviously, independent refiners in this bill must be seeking something more than freedom to operate in a cooperative form on behalf of patrons.

S. 1819 would allow such cooperatives to operate in the same manner as taxable corporations in dealing with nonmembers but without the obligation to pay a corporate income tax. We see no justification for exempting crude oil purchasing cooperatives from income tax where they are not operating on a cooperative basis with customers. In that capacity they are not different than any other business entity and should be taxed accordingly. Although Congress has provided rules permitting cooperatives to avoid a corporate level tax, these rules generally apply only to the extent of business done with patrons on a cooperative basis. While this restriction is relaxed somewhat in the case of farmers' cooperatives, S. 1819 would grant to crude oil purchasing cooperatives benefits in excess of even those available to farmers. There is no justification for such a tax preference.

Finally, such an amendment could have an adverse impact upon the Federal corporate tax receipts to the extent that exempt cooperatives deprive taxable corporations of profits from crude oil purchasing and related business. In addition, companies which must pay corporate taxes currently would be placed at a competitive disadvantage.

For all these reasons we oppose the enactment of S. 1819.

TREASURY NEWS

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EMBARGOED FOR RELEASE UPON DELIVERY
Expected at 10:30 A.M., EST
Tuesday, March 30, 1982

TESTIMONY OF THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY
BEFORE THE
HOUSE BANKING COMMITTEE

Mr. Chairman and Members of the Committee,

It is a pleasure to be with you today to discuss the economic outlook and the Budget. I hope this occasion will be part of an on-going dialogue between the Committee and the Administration over the need to restore a stable fiscal climate to promote long-term noninflationary growth in the American economy.

As you know, the economy continues in the grip of the second recession in two years. This latest downturn began in July 1981, hard on the heels of the sharp recession of 1980, from which the economy had never really recovered. Together they form one long period of near zero growth. The causes of the problem are clear: years of excessive money growth, rising inflation, rising interest rates, rising tax rates, and rising Federal spending as a share of GNP.

With the help of the Congress, we hope to continue the fight to bring Federal spending and deficits under control. With the help of the Federal Reserve, we hope to bring inflation and interest rates down. These steps will lead to an early end to the current downturn.

In spite of the continued slide in the first quarter of 1982, there are some hopeful signs. Excess inventories are being drawn down at a rapid rate. This is typical of the last stages of a recession. Retail sales are rising. Housing starts are up slightly. Durable goods orders have leveled off. And, very important for the financial well-being of all Americans, whether of working age or retirees, inflation continues to fall.

More importantly, we have in place a sound long-run tax system for the 1980's. It will not only help bring an early end to the current recession, but will promote rapid growth of income, savings, investment and employment for years to come. That tax system, with a healthy economy, will generate as much revenue as government should reasonably be allowed to spend.

However, the short-run revenue picture has been heavily affected by two factors: the recession and the drop in inflation -- one bitter pill and one piece of candy which together have significantly decreased revenue to the point of causing large deficits. The recession is temporary, and the decline in inflation is most welcome.

Nonetheless, nominal GNP is estimated to be 4 percent lower than was forecast last March, and the 1982 unemployment rate over one and one-half percentage points higher. These changes in economic assumptions have added roughly $60 billion to the deficit projections for FY-1983 compared to our estimate last year. Higher interest rates and a higher level of national debt by FY-1983 have added $30 billion more.

We, therefore, had to face some tough decisions about how to cover the costs of some very important government programs -- how to make up the difference between the $666.1 billion in revenues and the $757.6 billion in outlays -- until the growing economy triggered by our reformed tax system brings growing revenues into line with restrained outlays.

Some have urged us to revoke the incentive-creating tax cuts already in place. The result would have been lower real growth for many years into the future. It would have involved a self-defeating major change in a permanent tax program to handle a temporary problem. Instead, we shall propose certain worthwhile tax reforms, upgrade our tax collection program, renew our efforts at controlling spending, and borrow to cover the remaining deficit.

Deficits are not good. They rob the private sector of financial and real resources needed for growth, and divert those resources into government consumption. So do taxes. The root of the problem is the Federal spending which appropriates those real resources and then must find the means to pay for them in one way or another.

The budget deficit can and must be narrowed from the spending side. For too long, spending has been rising faster than the economy has grown. The economy can no longer support the burden. Some progress was made last year in reducing the runaway rate of growth in Federal non-defense spending. Further efforts will be required this year and into the future.

Insofar as spending is not reduced, it is preferable to close the remaining transitional recession deficits of the sort now being experienced by borrowing rather than by taxing. The funds are pulled from the private sector in either case, but taxes impose a larger cost in terms of reduced incentives for real growth.

Borrowing diverts a portion of private savings away from capital formation to enable the government to gain command over a portion of current output. Taxing also enables the government to have at its disposal a portion of current output. Taxation reduces private saving and it too cuts back the resources available for capital formation.

However, there is a difference. In recent years, tax increases have generally taken the form of allowing inflation to push taxpayers into higher brackets, or allowing inflation to erode the value of depreciation allowances. The former reduces the value of incremental present or future wages and interest income; the latter reduces the rate of return on plant and equipment. The effect is to reduce the supply of labor, savings, plant and equipment, cutting down on future output. Thus, taxation often produces disincentives which adversely affect future output, as well as directing a portion of current output to the government.

Federal borrowing creates debt that must be serviced, and this implies the future payment of taxes, but it need not require an increase in marginal tax rates, as long as economic growth produces an enlarged tax base. Thus, borrowing should have less adverse impact on future output than taxation.

Therefore, in deciding how to cover the transitional deficits associated with the current recession, we feel it is better to borrow, while leaving the tax incentives in place for long-run growth, rather than to undo the structural tax reforms of the ERTA, and choke off future expansion.

We must continue to strive to reduce the deficit by curtailing spending and promoting real growth. The budget we are proposing take major steps toward closing that deficit over the next several years. In the interim, it can be handled in a nondisruptive fashion. The first three charts help to put the deficit into perspective.

The projected deficits, though some of them are at record dollar levels, are not unusual following a recession when measured as a percent of GNP. On- and off-budget deficits were 3.6 and 4.5 percent of GNP in Fiscal Years 1975 and 1976, due largely to the 1974-1975 recession. Deficits are projected to be 3.8 percent and 3.1 percent of GNP in Fiscal Years 1982 and 1983, largely as a result of the current recession.

There has been considerable concern that our projected deficits will drive up interest rates. However, we believe there will be ample private sector saving to finance these

deficits and strong increases in capital formation. There will be no need for inflationary money creation by the Federal Reserve, which would indeed drive up interest rates.

The deficits will be manageable because of the growth of private sector saving. Private saving resulting from normal year-over-year growth and the Economic Recovery Tax Act will be several times greater than the total borrowing requirement of the Federal Government in 1983 and 1984 and thereafter.

The annual additions to total private saving are larger than the rise in the deficit. They will produce "crowding in" rather than "crowding out." This extra shot in the arm of capital markets will put downward pressure on interest rates. Even after financing the Federal deficit, there will be billions of additional dollars each year for private investment.

Normal year-to-year increases in saving exceed $40 billion each year. This will be supplemented by the additional personal savings and additional business retained earning induced by the tax cuts. Compared to 1981, private saving will be more than $60 billion higher in 1982, more than $170 billion higher in 1983, and more than $260 billion higher in 1984. Private saving was $480 billion in 1981. It is projected to rise to more than $740 billion in 1984.

Unfortunately, not all of this saving is available for growth and financing deficits. Some is needed to replace worn-out equipment. Net saving, which is gross saving less depreciation, is being diverted to finance government spending at an alarming rate, although not so severely as in the recession of 1974-1975 (see appendix). Fortunately, net saving will rise with gross saving. Nonetheless, every effort should be made to restrain Federal spending to promote future investment and growth.

Lack of growth has been responsible for much of the current and projected deficit. As a rough rule of thumb, each time growth falls off by enough to produce a 1 percent increase in unemployment, the budget deficit widens by more than $25 billion. In fact, if we had grown fast enough over the past four years to get unemployment down below 6 percent, the current deficit would be roughly $75 billion lower.

Growth is the only way to balance the budget while promoting rising real income and employment. I would like to point out, very firmly, that any changes in the economic recovery program which reduce real growth will tend to worsen the budget picture. Changes which reduce individual or business saving by as much as or more than the deficit will only worsen the situation in the credit markets.

The budget is not merely an accounting document. One cannot simply take a billion dollars out of column A and put it in column B. There are behavior changes and economic repercussions from tax and spending shifts which affect saving, investment, labor supply, income and revenue. Very often, changes which may look good on paper will buy little or no progress toward solving a budget problem, especially compared to the economic cost to the whole nation of the policy shift.

These facts should be kept clearly in mind as we look at the deficits in this budget.

Taxation, Spending and the Budget

The tax code we have in place, plus the tax proposals contained in the Administration's budget regarding obsolete provisions and improved tax compliance measures, will generate as much revenue over the long term as the government should reasonably be allowed to spend. We project long-term receipts of between 19 and 19-1/2 percent of GNP between 1983 and 1985 under our proposals. These percentages would rise slowly thereafter with real economic growth and scheduled payroll tax increases. This compares with 18.7 percent from 1964 through 1974 and 19.0 percent from 1975 through 1979. Receipts were 20.1 and 21.0 percent of GNP in 1980 and 1981, respectively, and will be approximately 20.3 percent in 1982. Receipts, therefore, will be in line with, or even higher than historical levels.

On the other hand, spending, on- and off-budget, is already too high and threatening to go higher. It was 23.0 and 23.7 percent of GNP in 1980 and 1981, respectively, and will exceed 24 percent of GNP in 1982. This compares to 19.8 percent from 1964 through 1974 and 22.1 from 1975 through 1979. We have recommended a decline to just over 21 percent of GNP by 1985, and further declines thereafter.

There is a general perception that spending and taxes have been slashed. In fact, all we have done so far is to reduce the rate of growth of spending, and we have just begun to see a modest tax reduction.

The personal tax rate reductions in the ERTA are not substantially larger between 1981 and 1984 than the continuing bracket creep and the payroll tax increases of 1981 and 1982. In fact, there was a net personal tax increase of roughly $15 billion in 1981. In 1982, taxpayers will barely break even. Not until 1983 and 1984 will there be real tax cuts for most families, totalling $12 to $15 billion each year. Taxes will rise again in 1985 due to a scheduled payroll tax increase.

On the other hand, even under our proposed spending restraint, spending will remain well above long-term averages for several years to come. If major budget changes are to be made, they should be in spending levels, not taxes.

Importance of a Stable Tax Policy

It is unlikely in the extreme that tax increases could succeed in balancing the budget. First, they would weaken the economy, and be partially offset by slower growth. Second, they would encourage higher government spending. In spite of the fact that the tax receipts of the Federal Government rose nearly $250 billion from FY-1977 to FY-1981, the government ran deficits of nearly $200 billion.

Consequently, the Administration hopes to balance the budget by restraining spending and encouraging growth through a stable incentive-creating tax program.

Business Taxes

Stability in tax policy is essential for private sector planning and economic recovery. Consider the impact of sudden changes in the tax law on the cost of plant and equipment and the related investment decisions.

Millions of firms planning billions of dollars of investment decisions must be in a situation of great uncertainty with respect to leasing, ACRS and other provisions. There is no way for a firm to determine whether an investment is practical or not until the tax picture is clarified. The decisions of the Congress regarding ACRS and related provisions have the power to unleash a flood of investment or to choke off tens of billions of dollars of spending on modernization and expansion of plant and equipment. Until the political decisions are made, the economic decisions, and the economic recovery, are on hold. The right decisions will start the economy climbing. The wrong ones will set it tumbling.

Taxes on Saving

Consider the impact on personal saving of a decision to suspend the third year of the tax cut and indexing. Under current law, over the life of a 10-year bond purchased in 1983, a taxpayer who will be in the 33 percent bracket following the third year of the tax cut would pay roughly one-third of his interest to the government. But without the third year and indexing, that tax rate would start at 39 percent and rise within a decade to 44 percent and 49 percent, as the taxpayer's income rises through the tax brackets with inflation. The average of these tax rates would probably be nearly 44 percent

At a 10 percent nominal interest rate and 5 percent or 6 percent inflation, this rise in the tax rate would be enough to cut a 2 percent real after-tax interest rate in half, or a 1 percent real after-tax interest rate to zero. Historically, such swings in the real after-tax interest rate have shifted the personal savings rate by one or even two percentage points. This would be enough to remove $25 to $50 billion dollars per year from the credit markets over the next decade, with obvious adverse consequences for interest rates, investment, and real growth.

Furthermore, the potential saver would know as soon as these provisions were repealed what the impact would be on the rate of return to saving. He would react at once, before the bond were purchased, not 5 or 10 years later after having committed money in good faith.

Taxes on Labor and Small Business

There are those who would preserve the business portions of the ERTA, and cancel most of the remaining individual tax rate reductions. Such a move would be extremely counter-productive to business as well as to individuals. I am frankly amazed at the lack of thought behind such proposals.

In my years at Merrill Lynch, I came to appreciate the importance of the individual in his or her role as saver, investor and entrepreneur. I am surprised that others in commerce or industry do not appreciate the importance of the individual in the roles of employee and customer.

Those who think of business only in terms of large corporations forget the millions of partnerships, proprietorships and sub-chapter S corporations whose profits are taxed at the individual level at individual tax rates. The decisions of these owner-investors and entrepreneurs are heavily influenced by the personal rate reductions and estate and gift tax reforms recently enacted.

As for employees and consumers, consider the effect of suspending the third year of the tax cut and indexing on the cost of labor and the standard of living of the American family.

Total net output of goods and services in the economy results from the combination of labor and capital. The value added by these two factors of production is reflected in the wages, salaries, rents, royalties, interest and dividends they receive. Value added equals total national income and total net output.

It may come as a surprise to some, but labor is far and away the larger of the two factors. Value added by labor is

between two-thirds and three-quarters of the total in most years for most products and industries. Labor inputs outweigh capital inputs two or three to one. It is time to remember that taxes on labor and the resulting higher labor costs are extremely damaging to American business.

Over the last 15 years, inflation, bracket creep and payroll tax hikes have sharply increased the pre-tax cost to the firm of giving a worker a one dollar after-tax wage increase.

A median income worker now faces 40 percent to 44 percent tax rates on added income. This is the sum of social security and Federal marginal income tax rates, plus state and local taxes at the margin. It is up sharply from the late 1960's, when the marginal rates would have been roughly 26 percent to 30 percent.

Consequently, it now costs a firm more than $1.70 to compensate a worker for a $1.00 increase in the cost of living. This is up from $1.40 in the late 1960's. Without indexing, it will rise to $2.00 by the late 1980's, and to $2.50 or higher in the 1990's. Any wage increase, whether merely COLA's or a real wage hike, would send taxes rising and tend to push labor costs up faster than the prices the firm receives for its products. Profits, employment, or real wages would tend to fall continually over time in the absence of extraordinary productivity increases. The competitive position of U.S. labor in the world economy would suffer.

The likely consequence of such a tax situation will be a falling after-tax wage. Labor will absorb a substantial portion of the tax burden. The cost of eliminating the third year of the tax cut and indexing to a wage earner making $20,000 in 1982 and receiving a cost-of-living increase thereafter would be substantial: $80 in 1983, $203 in 1984, $289 in 1985, and $369 in 1986. This is only the direct cost. The weaker economy, reduced saving, investment and growth, lower productivity and reduced demand for American labor would lower the market wage itself, reducing the family's real earnings by two or three times the direct cost of the higher taxes. American workers and savers are the primary customers of American business. There is no way such an impact on the real income of its customers would be good for business.

Regulatory Reform

My emphasis on the importance of the structural reforms of our tax system is consistent with this Administration's general regulatory reform program, the goals of which are also to promote savings and investment and to reduce the costs of government regulation for all sectors of the economy. The Administration's efforts are nowhere

more clear than with regard to the financial system, where in past years an outdated regulatory system has caused the redistribution of funds out of depository institutions to institutions offering new financial products and services. Thus, to assist our troubled thrift industry, the Administration has supported legislation to remove or lessen restrictions which prohibit thrift institutions from exercising broader lending powers and would permit, through separate subsidiaries, banks to compete in certain securities activities. Further, as a member of the Depository Institutions Deregulation Committee, I have been involved in the process of removing interest rate limitations on depository institutions so that they can compete equally to obtain funds with which to support their vital lending functions.

In addressing the earnings losses of thrift institutions, a variety of programs have been proposed which would involve costly temporary infusions which would increase the Federal budget deficit. We believe that Federal regulators now have the necessary powers to assist troubled institutions and that subsidy programs are not necessary. We have focussed on structural changes to give the industry the ability to be healthy in changing economic circumstances.

Importance of a Stable Monetary Policy

The President's original economic program included the recommendation that money growth be gradually reduced to a noninflationary pace. During the past year, the Federal Reserve made significant progress toward that goal.

Fourth quarter to fourth quarter, M1B grew by 5 percent in 1981. December to December, the rate was 6.4 percent due to rapid money growth at year's end. 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 was initially much more rapid -- almost three-fourths of the planned reduction in the first year -- until end-of-year increases in money growth rates raised the level of M1B above the lower end of last year's target range.

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 reductions in real output, employment, and real income. Lower inflation and lower real output mean lower GNP and lower Federal tax revenues. Lower inflation also means lower Federal outlays on indexed programs, but only with a considerable time lag. In the interim, the deficit widens. 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.

There are those who are urging the Federal Reserve to abandon its goal of a steady and moderate growth rate of the money supply. They believe that faster money growth would depress interest rates. History does not support that view, as the attached charts show.

For many years, it has been apparent that inflation is the main factor determining the level of interest rates. Excessively rapid money growth in the past has brought about the current high levels of interest rates. As inflation has risen or fallen in the past, interest rates haved moved in step.

In the last year or two, however, interest rates have risen relative to the inflation rate. This may be due, in part, to the unusual volatility of money growth rates since 1980.

In the last two months of 1980, M1 fell at an annual rate of 1.4 percent per year, after a sharp rise in the previous five months. All of the growth in M1 in 1981 occurred in the first four months of the year, when it grew at a 14.2 percent annual rate, and the last two months of the year, when M1 growth was at a 11.6 percent rate. In the interim, M1 was fairly flat. In the six months from April to October, the net change was a decrease of 0.2 percent, annual rate.

Early 1982 saw a very rapid increase in the money supply through January, followed by a levelling off in February. Currently, the level of M1 is $4 billion above the target range for 1982. The rapid growth of money from November

through January was accompanied by rising interest rates, reversing the dramatic decline in interest rates that had been under way since September.

The evidence of the past two years is very clear:

- Volatile money growth undermines 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.

- Faster growth of the monetary base produces faster growth of M1 and is associated with rising interest rates. Slower growth of the monetary base leads to slower money growth and falling interest rates.

The Administration strongly supports the Federal Reserve's announced goal of a steady and moderate rate of growth of the money supply, not because we seek to drive interest rates up, but because it is the only way to bring inflation and interest rates down on a permanent basis.

It is easy to illustrate why the financial markets watch the money supply so closely, and why variability of inflation and interest rates creates turmoil and uncertainty in the bond markets. Old securities must fall in price to remain competitive with new issues as interest rates rise. Conversely, bond prices rise when interest rates fall. Consider the history of the Treasury's 6-3/4 percent 20-year bond issued on October 1, 1973, priced at $99.50 per $100 of face value to yield 6.79 percent. Its value over time has fluctuated substantially with market interest rates:

	Price	Yield to Maturity
9/30/74	84.63	8.41
9/30/75	85.69	8.32
9/30/76	92.19	7.59
9/30/77	95.44	7.25
9/30/78	86.06	8.44
9/30/79	80.19	9.38
9/30/80	69.69	11.37
9/30/81	55.75	14.96
latest	62.50	13.38

As interest rates and bond prices have become increasingly unstable in recent years, the risk involved in buying bonds has increased. This has resulted in greater reluctance to buy bonds on the part of those who cannot afford a risky porfolio, and the emergence of a risk or volatility premium which has driven interest rates higher than normal relative to inflation in recent years. This is why stability in the rate of money growth and interest rates is critical to the success of our program.

APPENDIX

Full Employment Deficit

One way to illustrate the impact of the back-to-back recessions of 1980 and 1981-1982 on the budget deficit is to examine the high employment budget deficit. This concept has been used in the past to measure the "stimulus" of budget policy, on the theory that deficits increase total spending and pump up "demand". We reject the notion that deficits per se are inherently stimulative. They must be financed by borrowing in the absence of inflationary monetary creation. Nonetheless, the one useful insight the high employment budget does provide is a measure of the fundamental relationship between the current policy level of spending and the current tax code's capacity to generate revenue with the distorting effects of the recession removed.

The high employment budget estimates the budget aggregates that would result if the economy were continuously operating at a high level of employment under the tax and spending proposals contained in the FY-1983 Budget documents. The unemployment rate at high employment is traditionally estimated for this purpose to be about 5.0 percent. (However, many observers feel the real economy has a long-term basic unemployment rate somewhat higher.) Potential real GNP is assumed to grow 3.2 percent annually. (We believe this potential growth rate can be increased by proper policies, but have conformed to convention to provide estimates consistent with those of earlier years.)

The CEA has estimated the high employment deficit through FY-1985 on a unified budget basis. (The high employment deficit can be computed on a national income accounts (NIA) basis or on a unified budget basis. The major differences are the inclusion of offsetting receipts from oil and mineral leases and asset sales and the netting out of Federal retirement receipts and outlays in the unified budget.) The figures are available through FY-1985:

	FY 81	FY 82	FY 83	FY 84	FY 85
Receipts	636	691	723	768	830
Outlays	644	702	739	793	860
Deficit (-)	-8	-11	-16	-25	-30

It is clear from the tables that the major portion of the projected deficits of nearly $100 billion in FY-1982 and FY-1983 is due to the fact that the economy is operating at less than

full employment. The phased tax reductions result in small year-to-year increments in the high employment deficit, and,

even in "demand" terms, cannot be regarded as large or excessively stimulative. The bulk of the deficit increase, from $11 to $25 billion, is completed by FY-1984. By FY-1985, high employment receipts grow 8.1 percent over FY-1984, nearly matching the growth of outlays at 8.4 percent.

Savings Flows and How They Fit into the Scenario

The following outlines some of the concepts underlying the gross and net private savings figures commonly cited and provides background on the savings numbers consistent with the economic scenario underlying the budget. By whatever savings measure one prefers, projected deficits as a share of savings are less than in the 1974-1975 recession and the subsequent recovery, and are declining.

Concepts

- In the National Income and Product Accounts (NIPA), gross private saving is the sum of:
  - Personal saving -- the difference between after-tax personal income of the household sector and outlays of that sector for consumer goods and services, interest payments, etc.
  - Corporate saving, consisting of depreciation allowances plus undistributed after-tax profits. (This is equivalent to the cash flow available to corporations, both to maintain and add to productive assets. Inventory profits are excluded.)
  - Depreciation allowances of the noncorporate sector including unincorporated business enterprises plus imputed depreciation on owner-occupied homes. The latter, roughly $40 billion or about one-twelfth of gross private saving, is the only item in the saving figures which does not represent true cash flow.
- Gross private saving forms by far the larger part of total gross saving. In addition to private saving, the total includes the surplus of state and local governments (largely the surplus of the pension funds for their employees, as surpluses on operating account have been fairly narrow) and the surplus or deficit of the Federal Government. The latter is on a NIPA basis. In the next couple of years, the NIPA deficit will be wider than the more widely cited unified budget deficit (the difference arising from sales of mineral rights and other transactions that are not reflected in the NIPA but affect the unified budget).
- Table 1 attached presents historical data on gross savings flows as percentages of GNP.

- Net private saving in the accounts is comprised of personal saving and the undistributed profits of corporate business. (Profit-type income of unincorporated businesses gets into personal saving.) Depreciation allowances are not included in net saving. (The net saving figures are close to, but do not quite represent available cash for net investment, as undistributed profits and returns to unincorporated enterprises are after allowances have been made for full replacement of inventories and fixed capital used in the production process. They exclude inventory profits, and depreciation is on a so-called economic rather than book-basis, i.e., replacement rather than historical cost.) Savings or dissavings of government can be added to net private saving to get total net saving.

- Net saving figures are commonly compared with net national product (NNP, or GNP less depreciation allowances). Thus, depreciation is excluded from both numerator and denominator. Table 2 attached presents net savings flows as percentages of NNP.

- Domestic savings flows, either gross or net, may be augmented by inflows from abroad, which are likely to be attracted by the new tax climate.

- In an accounting sense, total gross saving (including any dissaving by the Federal Government) must match total gross investment -- the net additions to the stock of plant, equipment, inventories, and residential structures plus an amount sufficient to replace existing assets that have worn out or become obsolete. In any year, investment to replace existing assets far exceeds net additions to the stock of productive assets. Similarly, total net saving must equal net investment.

Gross Savings Flows in the Scenario

Savings flows consistent with the economic scenario underlying the 1983 Budget were worked up by the CEA. They were, of course, forced to fit within the constraint of the total uses of savings -- overall investment response to the rate of return changes in the ERTA plus Federal, state and local deficits and foreign flows. The breakdown between corporate and personal savings within the totals can be affected by dividend payout assumptions, capital intensity assumptions across corporate and non-corporate businesses, etc. In keeping within the totals, personal savings rates appear to have come out a bit low by historical standards.

The estimates yield substantial private savings flows, although they do not appear to be out of line with the sum of normal year-to-year growth, the business share of ERTA and historical responses by individuals to tax reductions.

o Historically, gross private saving has averaged about 16-1/2 percent of GNP. The peak ratio in the postwar period was 18.2 percent in the recession year of 1975. The next highest ratio was 17.5 percent in 1967. (See left-hand column of table 1 attached.)

Gross Private Saving as a Percent of GNP

	Budget scenario
1956-65	16.3
1966-75	16.6
1976-80	16.7
1981	16.4
1982	17.2 projected
1983	18.5 "
1984	19.1 "

o The impact of ERTA on gross private saving can roughly be estimated by calculating saving on the assumption that the historic 16-1/2 percent share of GNP had been maintained and comparing those numbers with the higher saving flows projected in the new scenario. The implication of these calculations is that gross private saving in the new scenario in 1985 is $101 billion more than if old saving patterns prevail.

Gross Private Saving

Calendar Year	Level in Budget (1)	Yearly Increase (2)	Level at 16.5% of GNP (3)	Difference from Budget (4) = (1)-(3)	Tax Cut ERTA (5)	Added Savings as % of ERTA (6)=(4)/(5)
	(----------- billions of dollars				-----------)	(percent)
1981 actual	480	--	--	--	--	--
1982 projected	542	62	521	21	58	36
1983 "	651	109	581	70	115	61
1984 "	742	91	641	101	151	67

- In terms of total saving flows, including government surplus, note that increased government deficits (dissaving) resulting from a tax cut have no effect on total saving if those tax cuts flow directly into increased private saving, as the funds from ACRS, which are recorded as retained earnings, might be expected to do. Of course, private saving may increase by more or less than any tax cut, depending on responses of households and businesses to changes in after-tax real rates of return on prospective investments. In the mid-1960's, personal savings increases, partly as a result of above average income growth, exceeded 70 percent of the marginal tax rate reductions for three years, rising to exceed the tax reductions in the fourth year and thereafter. The personal savings rates in the scenario assume a savings increase averaging roughly 45 percent of the personal tax cuts from 1982 to 1984.

Composition of Gross Private Saving in the Budget Scenario

- The rise in business saving reflects:

    1. A recovery of the profit share (before allowance for ACRS) and retention of a large portion of those increased profits, rather than their distribution in dividends.

    2. ACRS and other tax changes which reduce profits taxes by about $10 billion in CY-1982, $19 billion in CY-1983, and $27 billion in CY-1984.

    3. The depreciation thrown off by a rising stock of capital.

- The path of the personal saving rate is as follows:

	Personal Saving Rate (%) Budget scenario	
1980	5.6	
1981	5.3	
1982	6.7	projected
1983	7.0	"
1984	6.1	"

The dip in 1984 was conditioned by overall constraints imposed on the forecast, and appears to be an understatement. Personal saving available to households is related to prospective real after-tax rates of return; these should be vastly improved from returns available during the 1970's, and higher in 1984 than in 1983. Personal savings rates averaged 7.6 percent from 1965 to 1975.

Net Private Savings in the Scenario

Net saving figures indicate resources available to increase the stock of productive capital after allowance has been made for its maintenance.

- As indicated by the figures in the left-hand columns of table 2, ratios of total and net private saving to net national product (NNP) were severely eroded in the late 1970's. In 1981, net private saving was 6.1 percent of NNP compared with 8-3/4 percent during the late 1960's. The scenario shows that late 1960's ratio being restored, though not surpassed.

	Net private saving as percent of NNP	Federal deficit as percent of net private savings plus S&L surplus
1956-65	8.1	- 2.8
1966-75	8.6	-14.5
1974	7.6	-10.9
1975	8.9	-53.8
1976	7.7	-39.0
1977	7.3	-30.0
1978	6.9	-17.9
1979	6.7	- 8.6
1980	6.2	-35.0
1981	6.1	-31.8
1982 projected	7.0	-45.0
1983 "	8.7	-32.0
1984 "	8.8	-28.0

- The right-hand column of table 2 and the tabulation on the prior page show the ratio of the NIPA Federal deficit to the total net private savings plus supluses (if any) of state and local governments. That ratio hit a peak of 54 percent in 1975. As indicated on the prior page, that ratio in the scenario for 1982 never approaches the 1975 figure, and ratios for 1983 and 1984 stay below respective figures for 1976 and 1977.

	Gross private saving as percent of GNP		Net private saving as percent Of NNP	
	Administration	DRI	Administration	DRI
1981 actual	16.4	16.3	6.1	6.0
1982	17.2	16.7	7.0	5.8
1983	18.5	17.7	8.7	7.0
1984	19.1	18.4	8.8	7.6

GROSS SAVING AND INVESTMENT

LEVELS

	1979	1980	1981	1982	1983	1984
Gross Private Saving	400.0	434.1	478.7	542.0	650.7	741.8
Personal	86.2	101.4	106.6	150.8	171.7	163.4
Business	313.9	332.7	372.1	391.3	479.0	578.4

PERCENTS OF GNP

	1979	1980	1981	1982	1983	1984
Gross Private Saving	16.6	16.5	16.4	17.2	18.5	19.1
Personal	3.6	3.9	3.6	4.8	4.9	4.2
Business	13.0	12.7	12.7	12.4	13.6	14.9

PERCENT OF GNP

	GROSS PRIVATE SAVING	PERSONAL	CORPORATE	RETAINED EARNINGS	CORPORATE CAP.CONS. ALLOWANCE	NONCORP. CAP.CONS. ALLOWANCE	TOTAL GOVT.	FEDERAL	STATE & LOCAL	NET FOREIGN INVESTMENT	GROSS PVT. DOMESTIC INVESTMENT	PERSONAL SAVING RATE
1947	11.715	2.247	6.062	2.021	4.041	3.400	6.178	5.743	0.436	3.989	14.767	3.100
1948	15.943	4.292	8.100	3.848	4.252	3.538	3.255	3.205	0.051	0.930	15.856	5.900
1949	15.080	2.896	8.370	3.767	4.603	3.832	-1.302	-1.021	-0.281	0.339	14.847	4.000
1950	14.891	4.160	6.988	2.520	4.468	3.734	2.794	3.214	-0.421	-0.645	16.416	5.800
1951	15.371	4.856	6.792	2.293	4.499	3.714	1.834	1.968	-0.134	0.266	14.779	7.100
1952	15.746	4.999	6.967	2.356	4.611	3.800	-1.087	-1.073	-0.014	0.180	14.075	7.300
1953	15.467	5.049	6.630	1.973	4.657	3.789	-1.890	-1.929	0.039	-0.348	14.423	7.300
1954	15.829	4.629	7.244	2.285	4.958	3.956	-1.948	-1.645	-0.303	0.062	14.790	6.600
1955	16.090	4.111	8.139	3.283	4.856	3.840	0.786	1.104	-0.318	0.111	15.604	6.000
1956	16.772	5.059	7.777	2.529	5.248	3.936	1.231	1.439	-0.207	0.655	15.728	7.300
1957	16.738	5.020	7.776	2.324	5.453	3.942	0.208	0.514	-0.306	1.083	15.284	7.200
1958	16.739	5.241	7.433	1.827	5.606	4.066	-2.808	-2.284	-0.523	0.199	14.101	7.400
1959	16.369	4.332	8.214	2.827	5.387	3.823	-0.324	-0.233	-0.091	-0.236	14.853	6.200
1960	15.399	3.884	7.766	2.381	5.385	3.749	0.611	0.599	0.012	0.557	14.399	5.600
1961	15.818	4.386	7.719	2.375	5.344	3.713	-0.811	-0.741	-0.070	0.728	13.813	6.300
1962	16.010	4.122	8.339	3.221	5.118	3.548	-0.670	-0.752	0.082	0.600	14.010	6.000
1963	15.566	3.669	8.443	3.419	5.024	3.454	0.120	0.043	0.077	0.740	14.234	5.400
1964	16.670	4.635	8.669	3.742	4.927	3.366	-0.356	-0.513	0.156	1.070	14.385	6.700
1965	17.316	4.871	9.171	4.336	4.835	3.275	0.076	0.077	-0.001	0.786	15.001	7.100
1966	17.014	4.756	9.052	4.234	4.819	3.206	-0.170	-0.237	0.066	0.401	14.758	7.000
1967	17.497	5.542	8.705	3.720	4.985	3.250	-1.781	-1.648	-0.132	0.323	14.069	8.100
1968	16.254	4.802	8.214	3.200	5.014	3.238	-0.683	-0.693	0.010	0.069	14.360	7.100
1969	15.216	4.300	7.591	2.443	5.149	3.325	1.053	0.893	0.159	0.042	14.773	6.400
1970	15.978	5.619	6.938	1.488	5.450	3.421	-1.065	-1.253	0.188	0.323	14.202	8.000
1971	16.734	5.628	7.412	2.115	5.527	3.429	-1.805	-2.044	0.239	-0.067	14.733	8.100
1972	15.958	4.436	8.076	2.576	5.500	3.473	-0.281	-1.418	1.138	-0.429	15.583	6.500
1973	17.166	5.953	7.788	2.435	5.353	3.428	0.590	-0.422	1.012	0.490	15.931	8.600
1974	16.353	5.935	6.749	0.936	5.813	3.669	-0.330	-0.804	0.474	0.201	14.956	8.500
1975	18.247	6.086	8.300	1.878	6.422	3.861	-4.119	-4.472	0.353	1.179	13.749	8.600
1976	17.136	4.802	8.542	2.148	6.395	3.793	-2.125	-3.090	0.964	0.298	14.321	6.900
1977	16.808	3.863	9.104	2.725	6.380	3.841	-0.956	-2.418	1.463	-0.723	15.709	5.600
1978	16.483	3.541	9.009	2.685	6.324	3.933	-0.010	-1.355	1.344	-0.639	16.381	5.200
1979	16.525	3.570	8.885	2.447	6.437	4.070	0.494	-0.614	1.108	-0.070	16.501	5.200
1980	16.485	3.857	8.366	1.687	6.679	4.257	-1.222	-2.330	1.108	0.225	15.277	5.600
1981	16.344	3.648	8.459	1.694	6.765	4.233	-0.859	-2.108	1.249	0.079	14.797	5.300
FIVE YEAR AVERAGES												
1951-1955	15.701	4.728	7.154	2.438	4.716	3.820	-0.461	-0.315	-0.146	0.054	14.734	6.860
1956-1960	16.404	4.707	7.793	2.378	5.416	3.903	-0.216	0.007	-0.223	0.452	14.873	6.740
1961-1965	16.276	4.337	8.468	3.419	5.049	3.471	-0.328	-0.377	0.049	0.785	14.289	6.300
1966-1970	16.392	5.004	8.100	3.017	5.083	3.288	-0.529	-0.587	0.058	0.232	14.433	7.320
1971-1975	16.891	5.608	7.711	1.988	5.723	3.572	-1.189	-1.832	0.643	0.274	14.491	8.060
1976-1980	16.687	3.927	8.781	2.338	6.443	3.979	-0.764	-1.961	1.197	-0.182	15.638	5.700

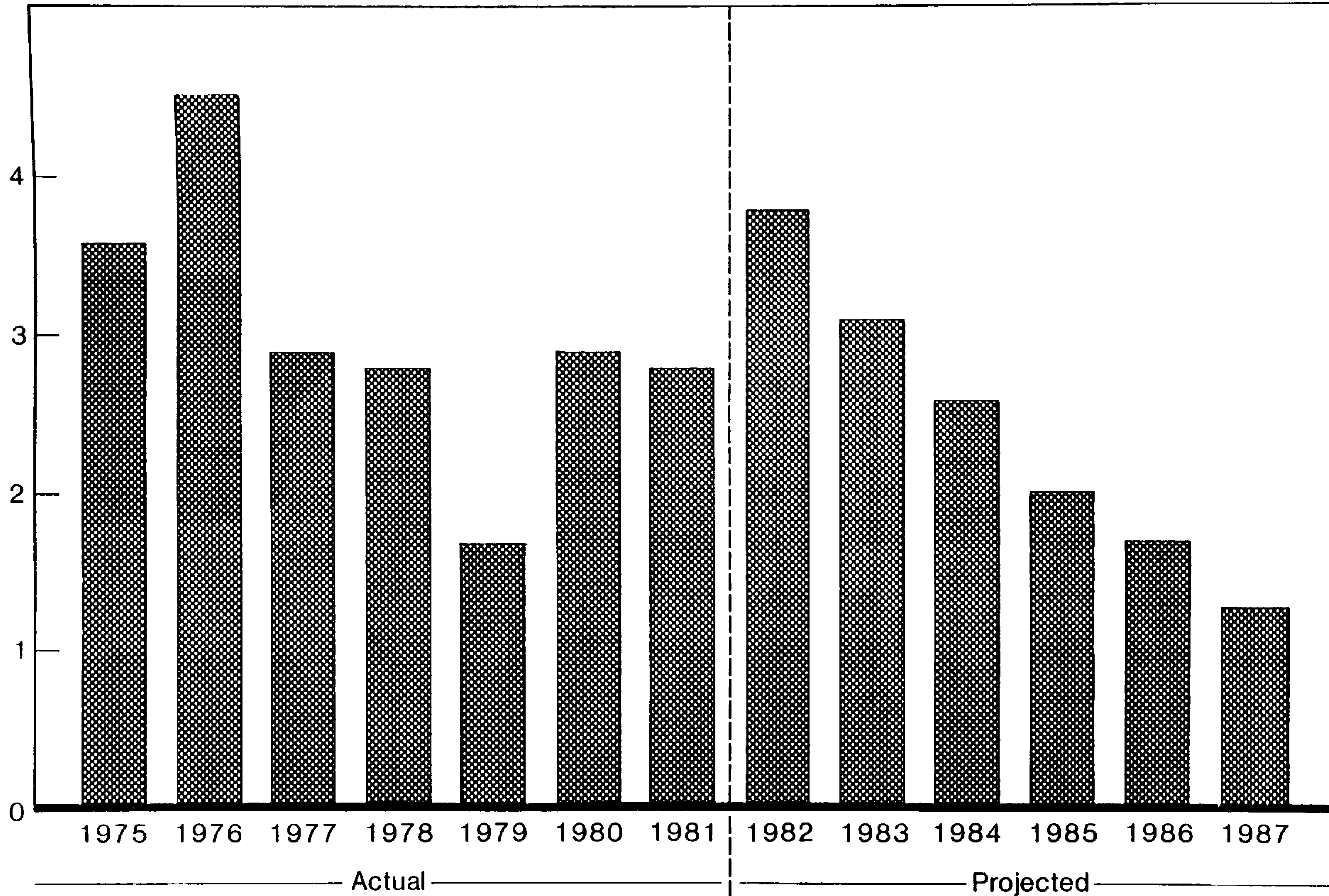
Table 1

Table 2

2/9/82

NET SAVINGS

	PERCENT OF NET NATIONAL PRODUCT						PERCENT OF PRIVATE PLUS S&L SAVINGS
	TOTAL	PRIVATE	PERSONAL	CORPORATE	STATE & LOCAL	FEDERAL	FEDERAL
1947	11.29	4.61	2.43	2.18	0.47	6.20	122.11
1948	12.36	8.83	4.65	4.17	0.06	3.48	39.12
1949	5.86	7.28	3.16	4.11	-0.31	-1.12	-16.00
1950	10.32	7.28	4.53	2.75	-0.46	3.50	51.35
1951	9.79	7.79	5.29	2.50	-0.15	2.14	28.05
1952	6.84	8.03	5.45	2.57	-0.01	-1.17	-14.63
1953	5.60	7.67	5.51	2.15	0.04	-2.11	-27.32
1954	5.45	7.59	5.08	2.51	-0.33	-1.81	-24.88
1955	8.96	8.10	4.50	3.60	-0.35	1.21	15.61
1956	9.71	8.36	5.57	2.79	-0.23	1.58	19.49
1957	8.33	8.10	5.54	2.56	-0.34	0.57	7.30
1958	4.72	7.82	5.80	2.02	-0.58	-2.53	-34.90
1959	7.53	7.89	4.77	3.11	-0.10	-0.26	-3.30
1960	7.57	6.89	4.27	2.62	0.01	0.66	9.55
1961	6.54	7.43	4.82	2.61	-0.08	-0.81	-11.07
1962	7.31	8.04	4.51	3.53	0.09	-0.82	-10.12
1963	7.88	7.74	4.01	3.74	0.08	0.05	0.60
1964	8.75	9.13	5.05	4.08	0.17	-0.56	-6.01
1965	10.10	10.02	5.30	4.72	0.00	0.08	0.83
1966	9.59	9.77	5.17	4.60	0.07	-0.26	-2.61
1967	8.15	10.09	6.04	4.05	-0.14	-1.80	-18.06
1968	7.98	8.72	5.23	3.49	0.01	-0.75	-8.64
1969	8.52	7.37	4.70	2.67	0.17	0.98	12.94
1970	6.63	7.80	6.17	1.63	0.21	-1.37	-17.17
1971	6.52	8.50	6.18	2.32	0.26	-2.24	-25.60
1972	7.40	7.70	4.87	2.83	1.25	-1.56	-17.40
1973	9.84	9.20	6.53	2.67	1.11	-0.46	-4.48
1974	7.23	7.59	6.56	1.03	0.52	-0.89	-10.94
1975	4.29	8.88	6.78	2.09	0.39	-4.98	-53.77
1976	5.37	7.74	5.35	2.39	1.07	-3.44	-39.04
1977	6.27	7.34	4.30	3.03	1.63	-2.69	-30.04
1978	6.93	6.94	3.95	2.99	1.50	-1.51	-17.89
1979	7.28	6.72	3.99	2.73	1.24	-0.69	-8.62
1980	4.85	6.23	4.33	1.89	1.24	-2.62	-35.03
1981	5.04	6.00	4.10	1.90	1.40	-2.37	-31.98
FIVE YEAR AVERAGES							
1951-1955	7.33	7.83	5.17	2.67	-0.16	-0.35	-4.64
1956-1960	7.57	7.81	5.19	2.62	-0.25	0.01	-0.37
1961-1965	8.11	8.47	4.74	3.73	0.05	-0.41	-5.15
1966-1970	8.17	8.75	5.46	3.29	0.06	-0.64	-6.71
1971-1975	7.05	8.37	6.18	2.19	0.71	-2.03	-22.44
1976-1980	6.14	6.99	4.38	2.61	1.34	-2.19	-26.13

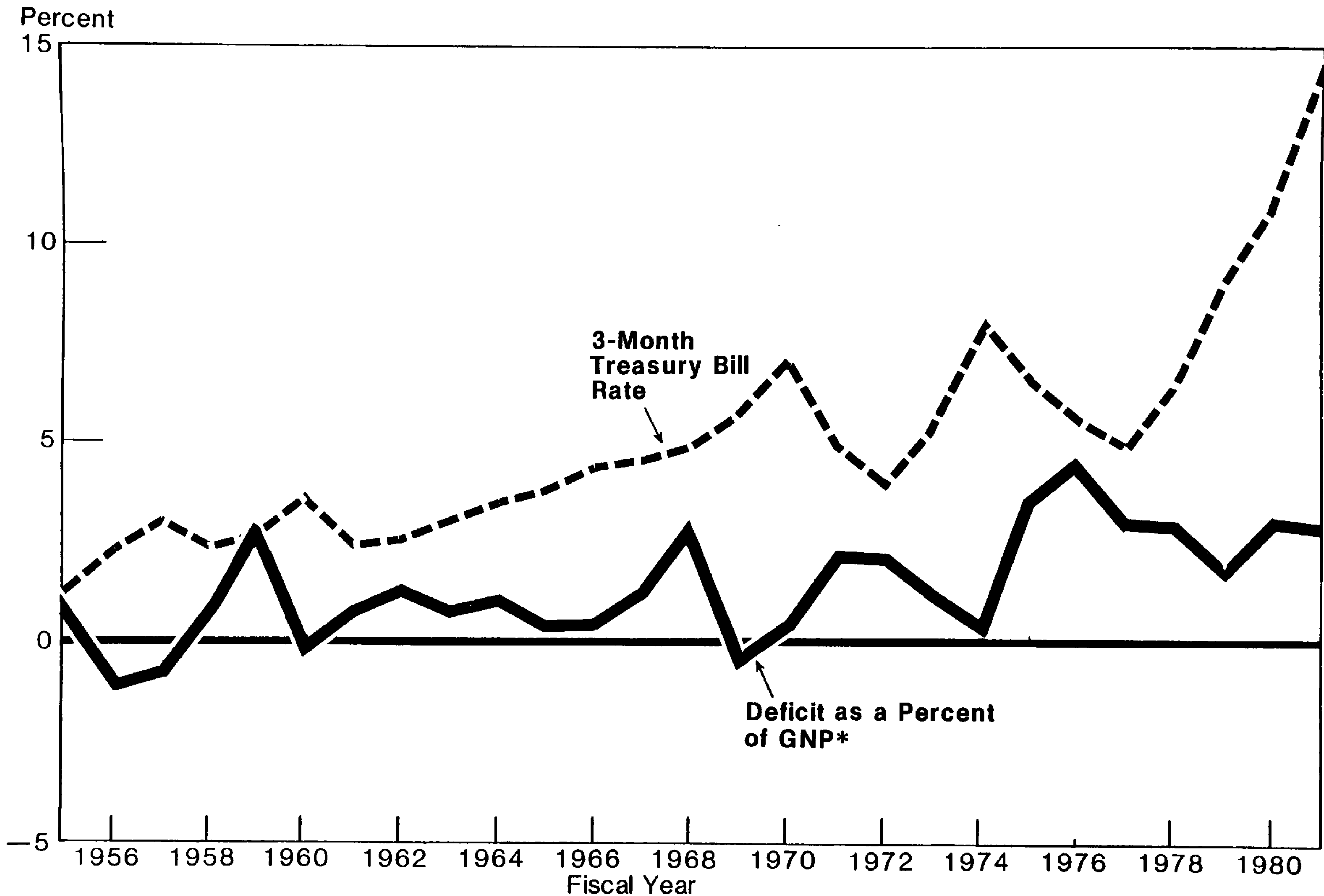

Budget Deficits in Relation to GNP*
Percent
4
3
2
1
0
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
Actual
Projected
* On and off budget as percent of fiscal year GNP.

Budget Deficits in Relation to GNP

Fiscal Year		Deficits (Bil. of dols.)	Percent of GNP
1975		-53.2	-3.6
1976		-73.7	-4.5
1977		-53.6	-2.9
1978		-59.2	-2.8
1979		-40.2	-1.7
1980		-73.8	-2.9
1981	actual	-78.9	-2.8
1982	projected	-118.3	-3.8
1983		-107.2	-3.1
1984		-97.2	-2.6
1985		-82.8	-2.0
1986		-77.0	-1.7
1987		-62.5	-1.3

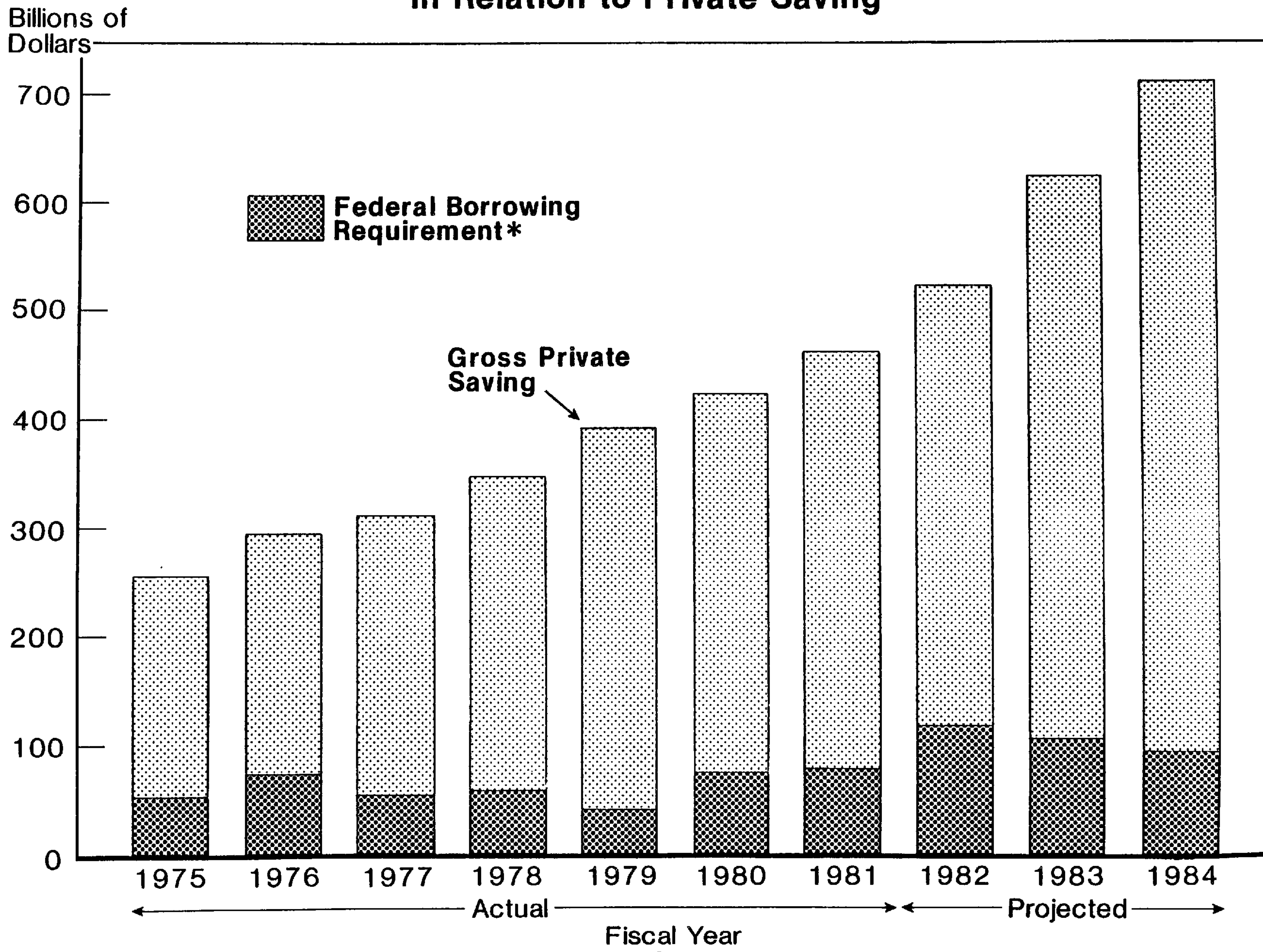
Note: Figures include off-budget entities.

3/23/82



* Federal surplus or deficit includes off-budget items. Points below zero line represent surplus as percent of GNP, points above line a deficit.

Projected Borrowing Requirement in Relation to Private Saving



* Total budget deficit including off-budget entities.

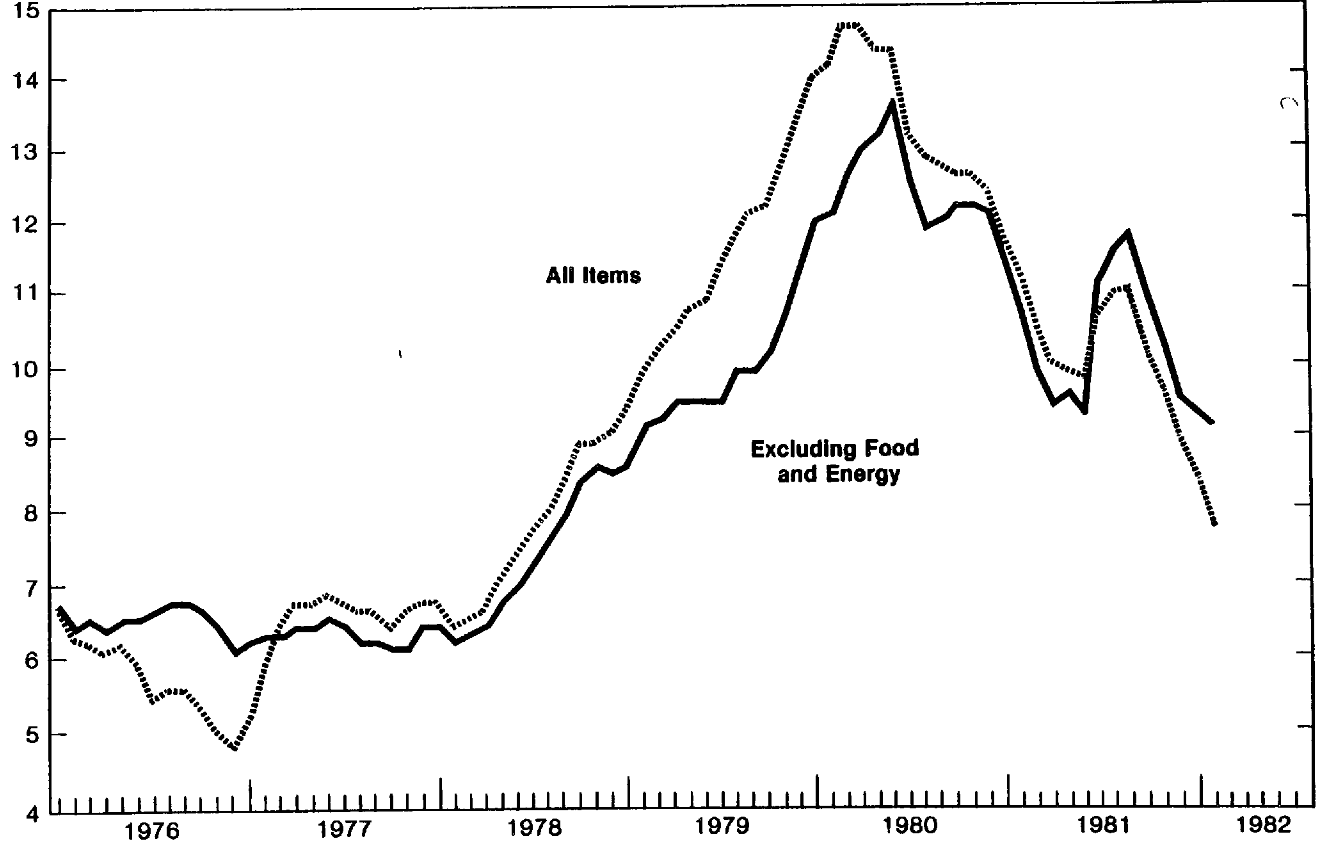
Note: Saving flows do not reflect surpluses of state and local governments or inflows from abroad

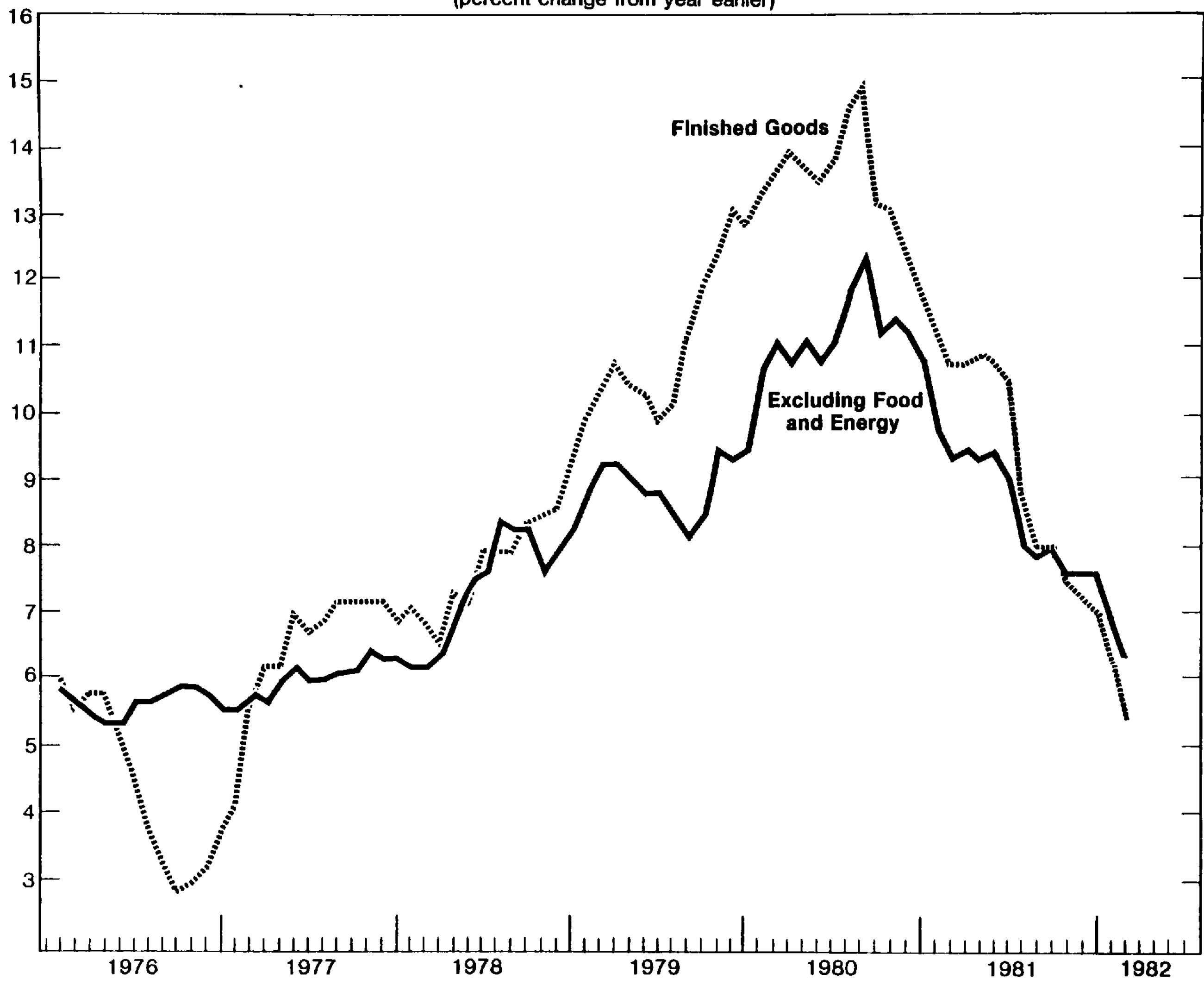
March 24, 1982

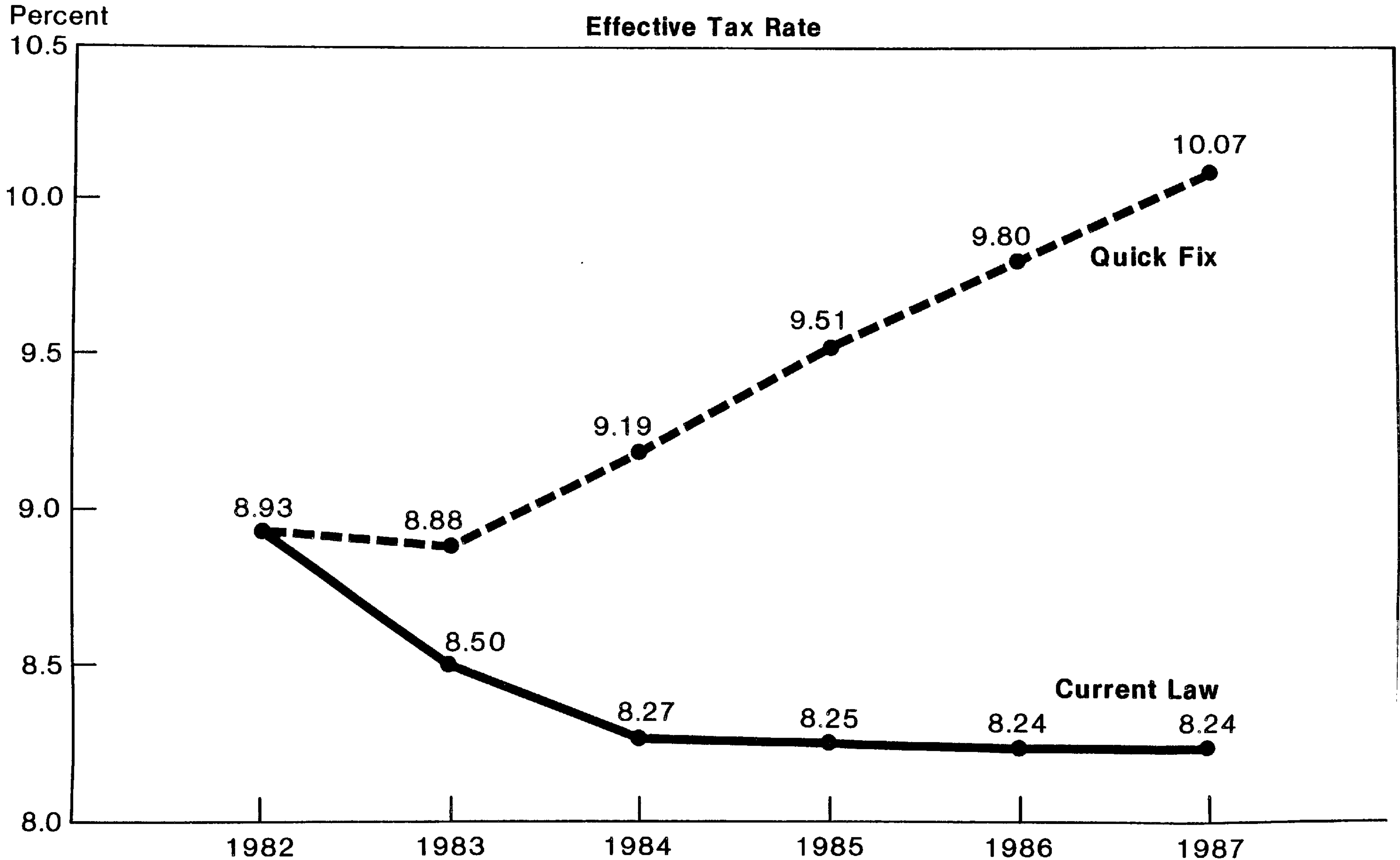
Projected Borrowing Requirement in Relation to Private Saving

Fiscal year		Gross private saving	Federal deficit including off-budget	Deficit as share of saving
		(---billions of dollars---)		(percent)
1975		253.4	-53.2	-21.0
1976		295.6	-73.7	-24.9
1977		309.8	-53.6	-17.3
1978		347.4	-59.2	-17.0
1979		392.2	-40.2	-10.2
1980		423.0	-73.8	-17.4
1981	actual	462.3	-78.9	-17.1
1982	projected	523	-118.3	-22.6
1983		624	-107.2	-17.2
1984		712	-97.2	-13.7

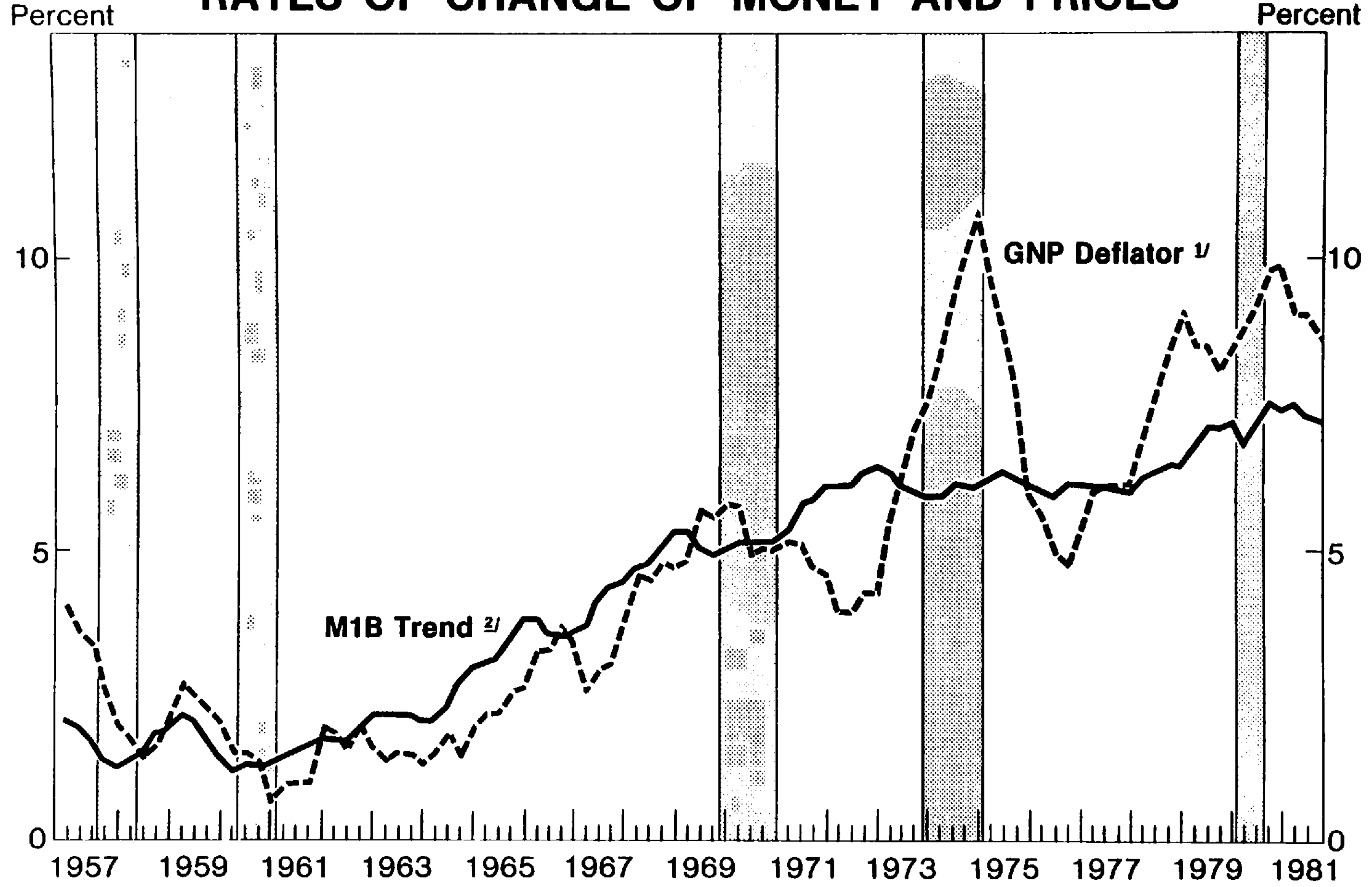
3/23/82


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


Producer Prices
(percent change from year earlier)
percent
16
15
14
13
12
11
10
9
8
7
6
5
4
3
Finished Goods
Excluding Food
and Energy
1976
1977
1978
1979
1980
1981
1982

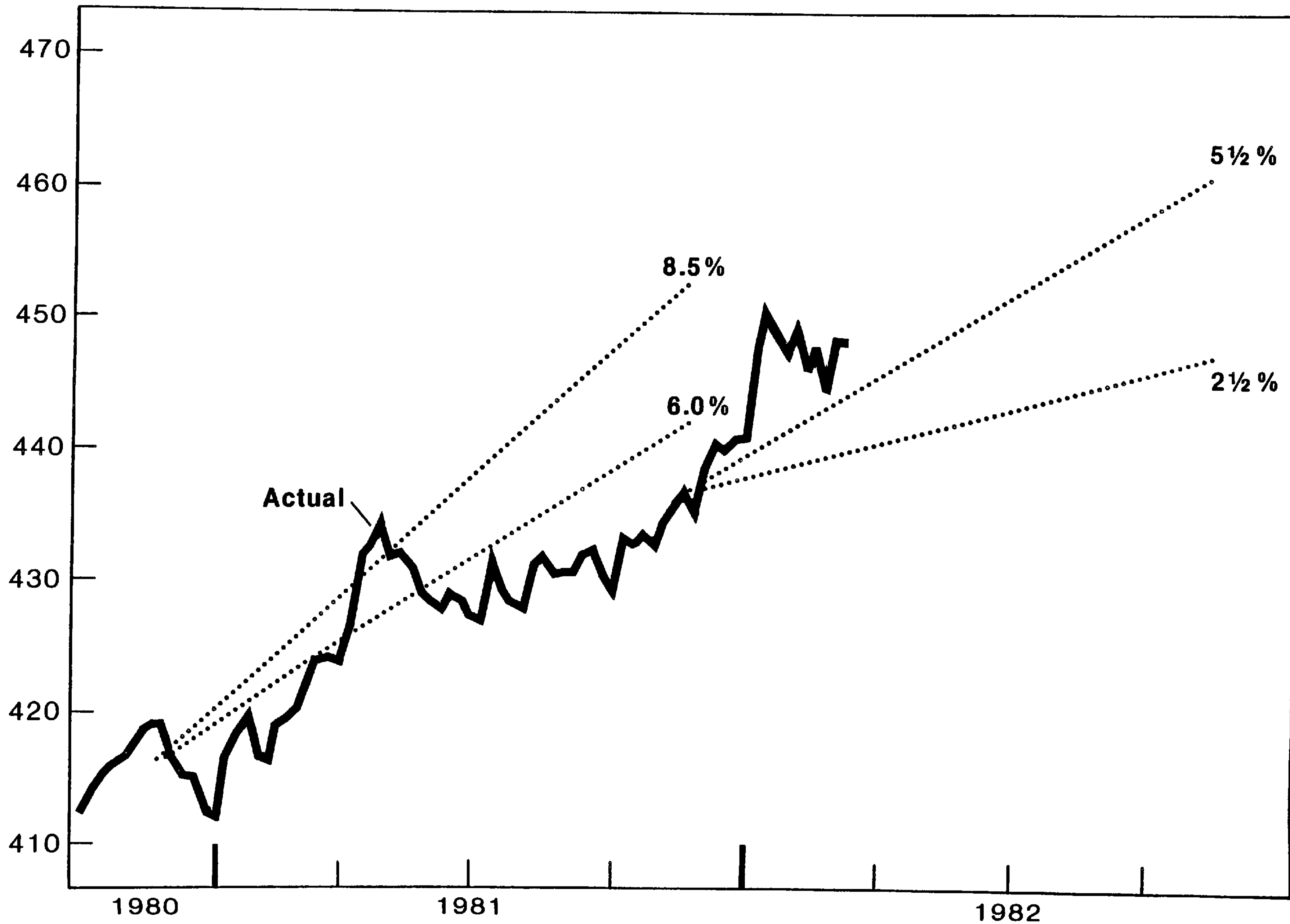


Quick Fix alternative leaves the July 1, 1982 tax rate reduction in place, but cancels the July 1, 1983 tax rate reduction and indexing.

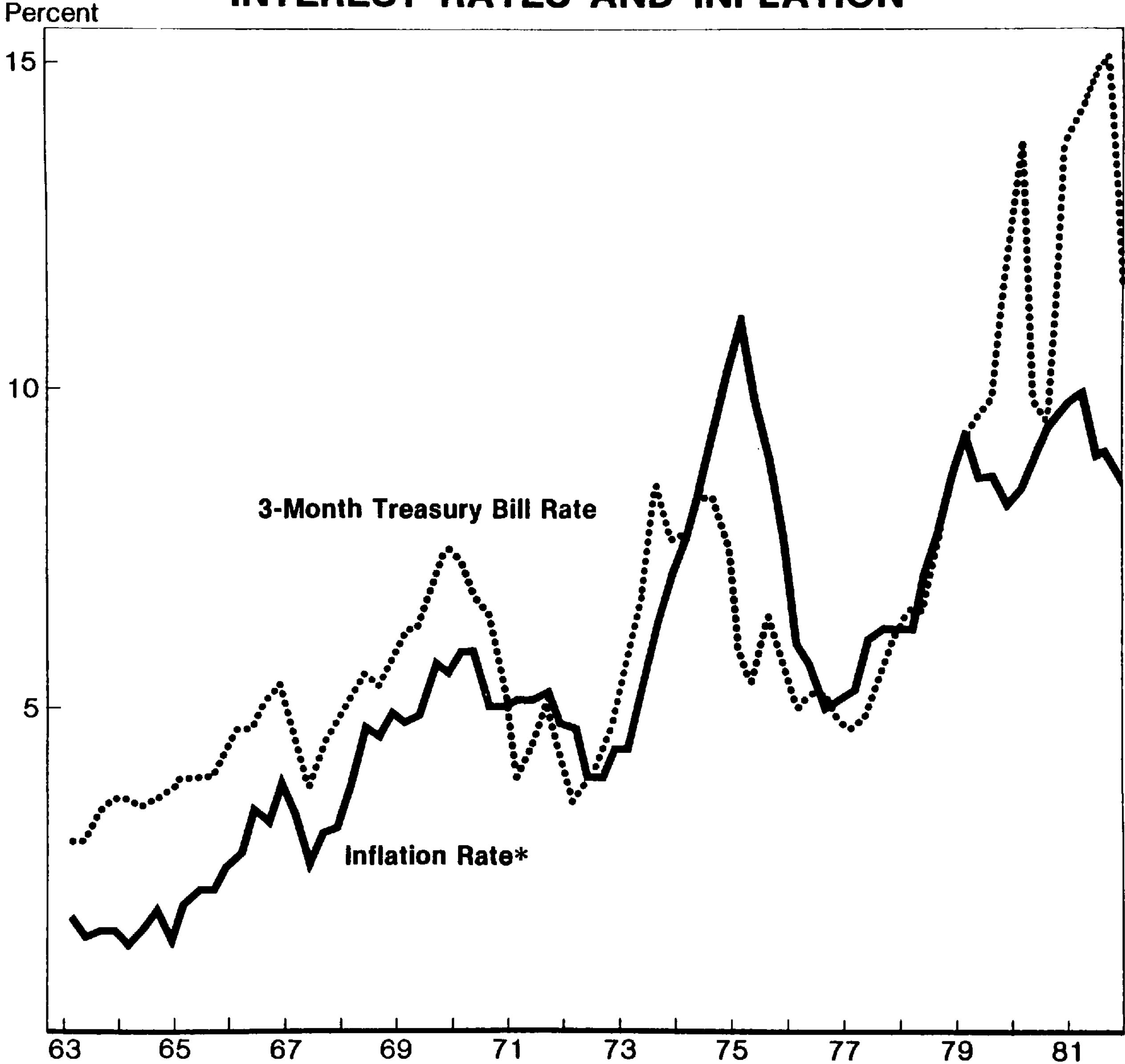


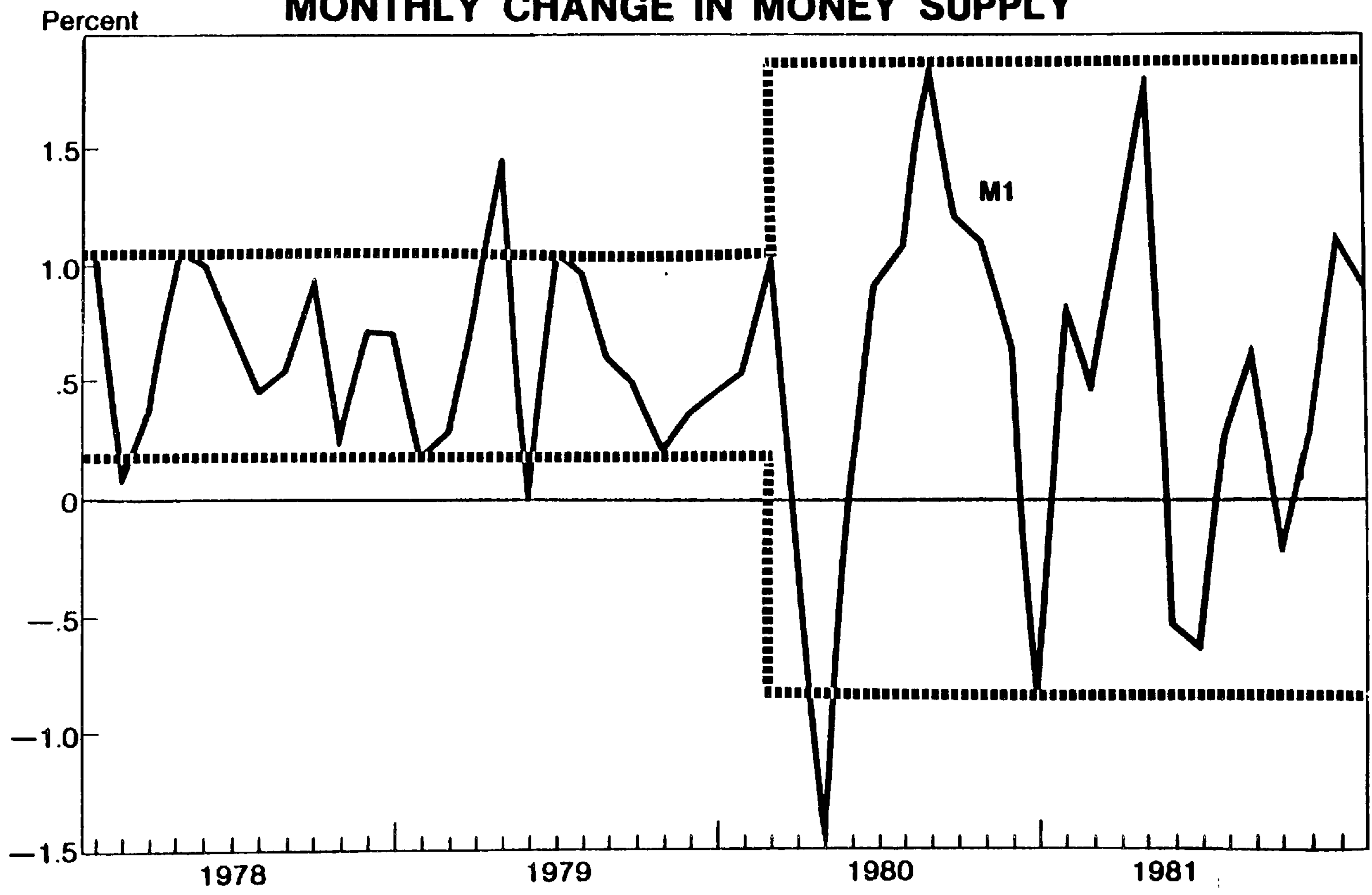
1/ Four-quarter rate of change;
2/ Twenty-quarter rate of change; data prior to 1st quarter 1964 are M1.
Latest data plotted: 4th quarter

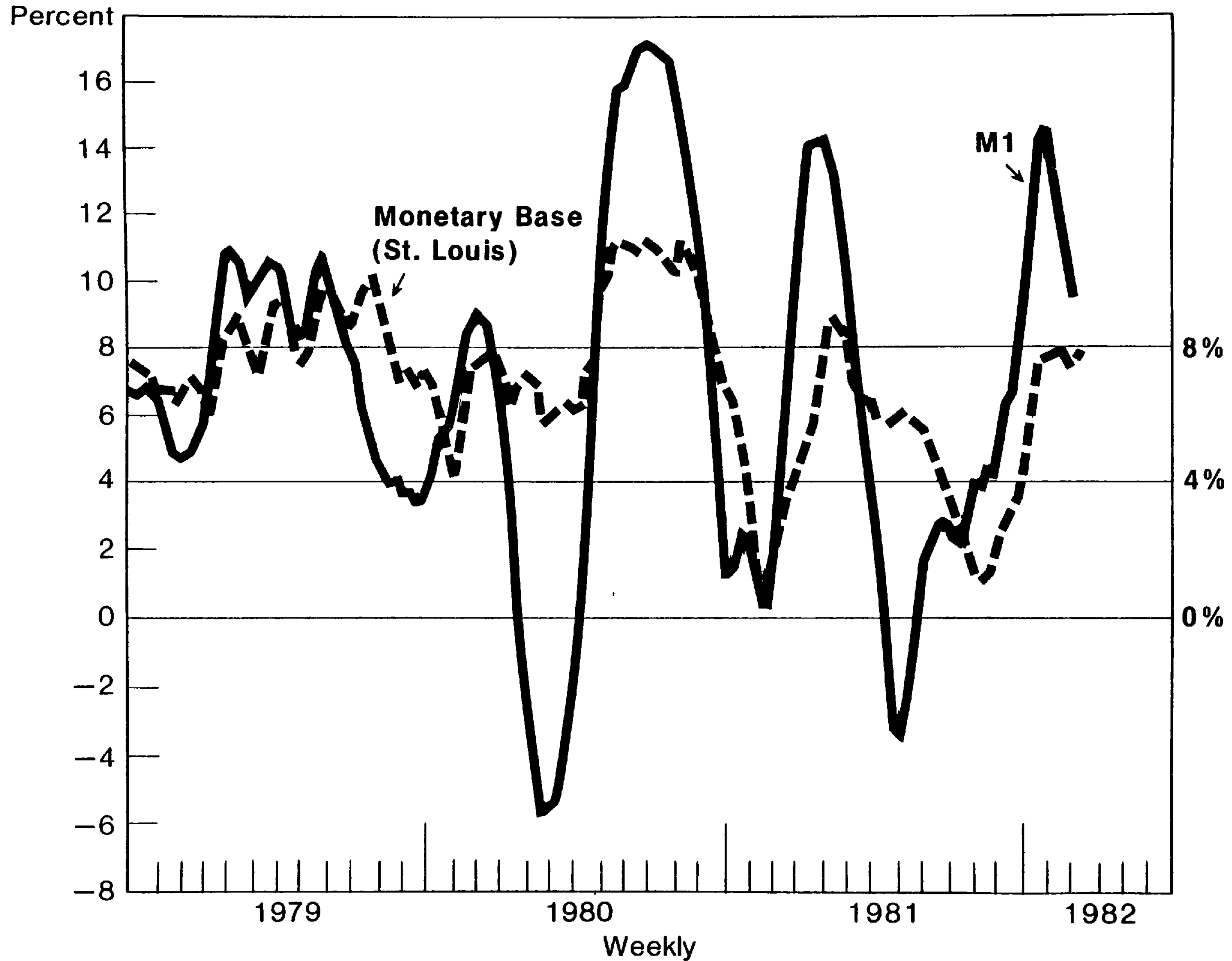
January 27, 1982-A164



M1 VERSUS TARGET RANGE*
470
460
450
440
430
420
410
8.5%
6.0%
5½ %
2½ %
Actual
1980
1981
1982
*Weekly Averages-Seasonally Adjusted


INTEREST RATES AND INFLATION
Percent
15
10
5
3-Month Treasury Bill Rate
Inflation Rate*
63
65
67
69
71
73
75
77
79
81
* Growth from year earlier in GNP deflator.
Plotted quarterly.
January 27, 1982-A159

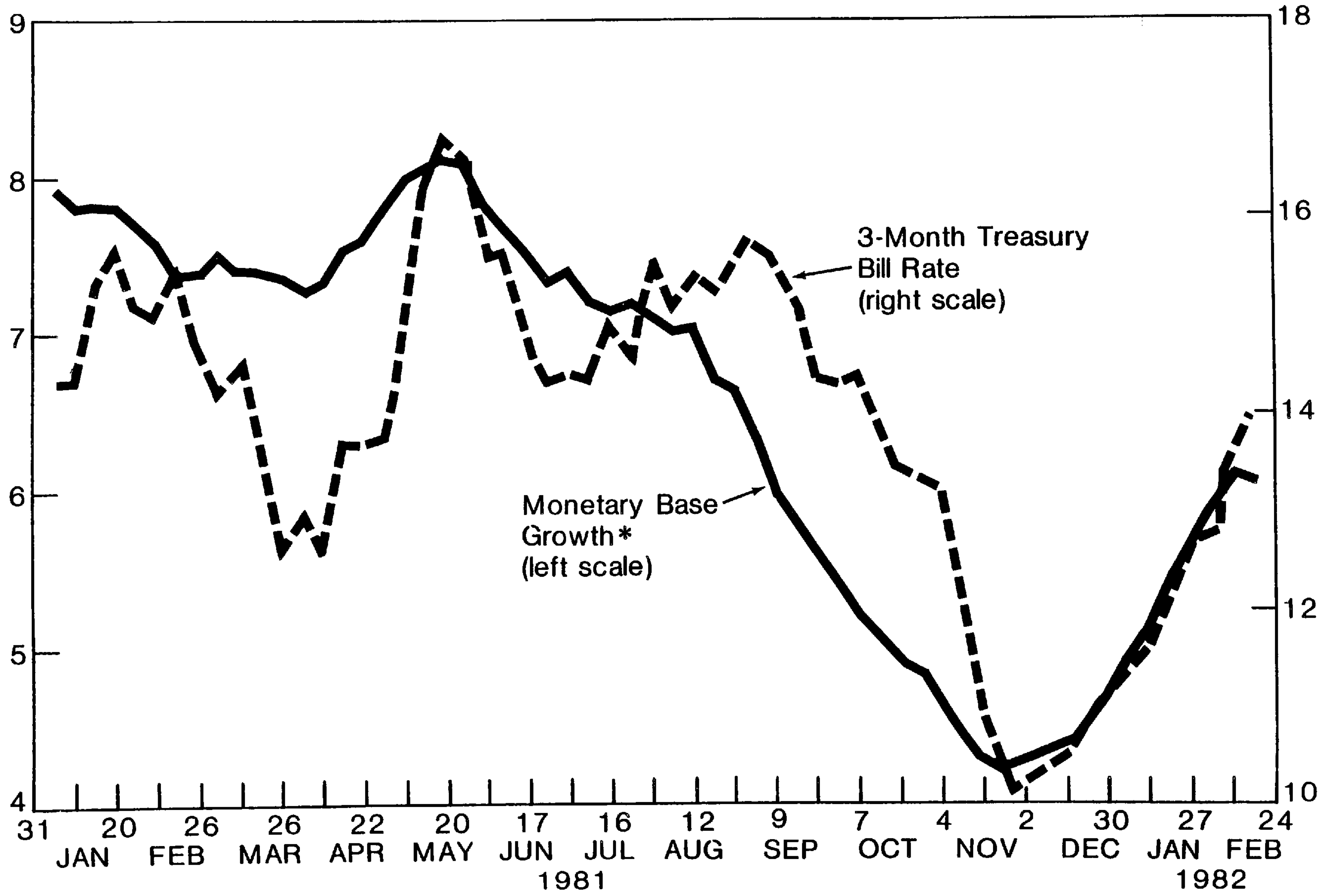

MONTHLY CHANGE IN MONEY SUPPLY
Percent
1.5
1.0
.5
0
—.5
—1.0
—1.5
M1
1978
1979
1980
1981



*Quarterly growth rates based on four-week averages compared with four-week averages thirteen weeks earlier, at annual rates. Latest week plotted: March 3 for M1, March 10 for monetary base.

NOTE: Monetary Base data do not reflect recent revisions in the series by the St. Louis Federal Reserve.

Monetary Base Growth vs. 3-Month T-Bill

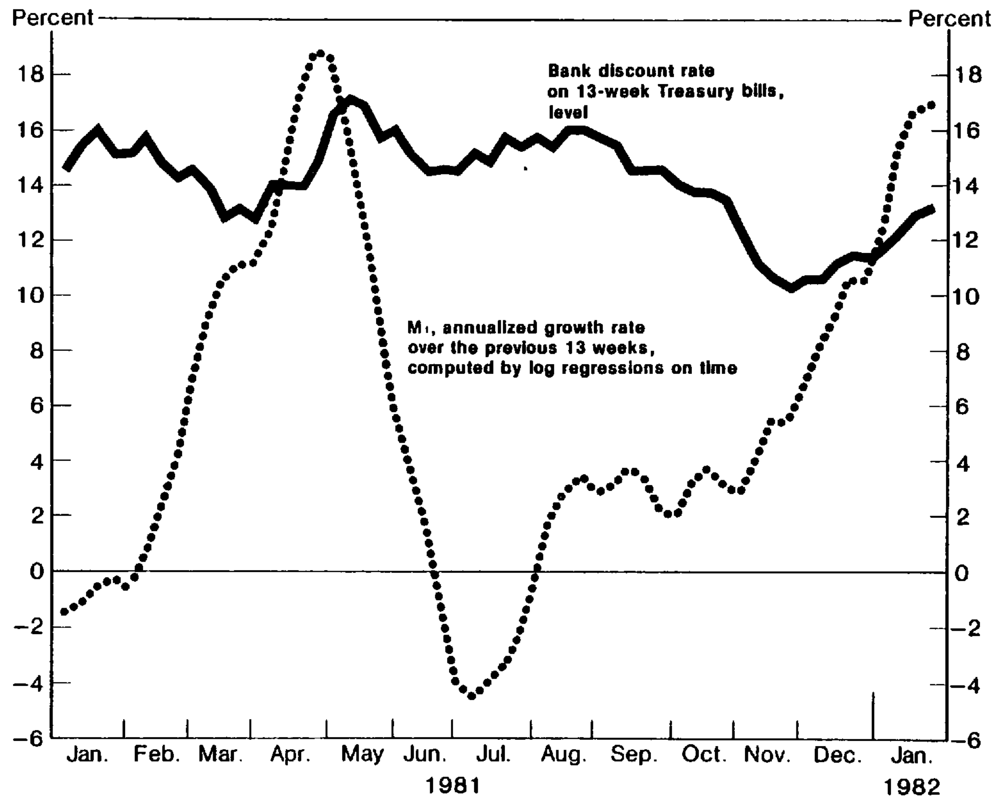


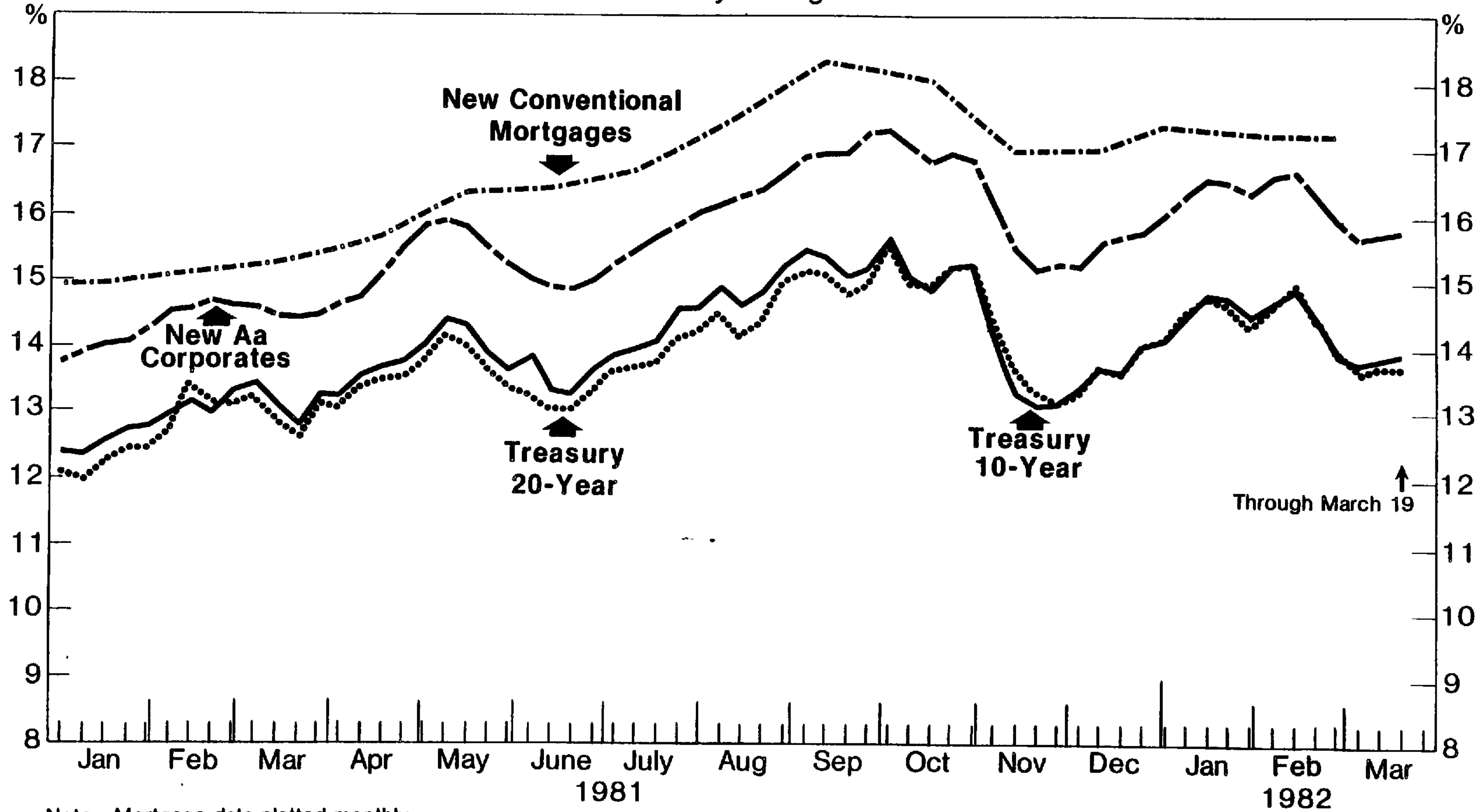
*52 Week Growth on 4-Week Moving Averages

NOTE: Monetary Base data do not reflect recent revisions in the series by the

March 24, 1982

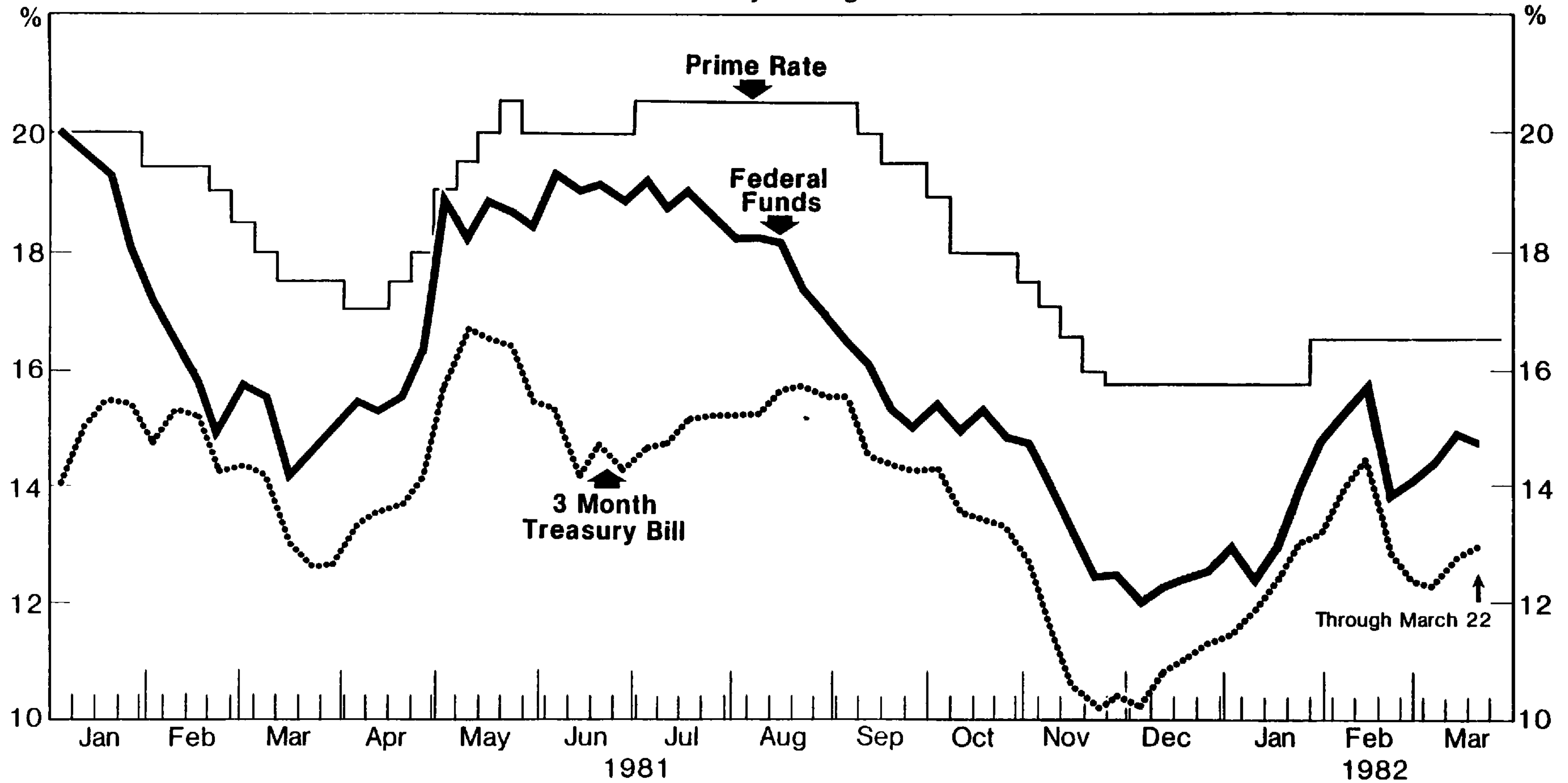
THE THREE-MONTH TREASURY BILL RATE AND GROWTH OF M_1





Office of the Secretary of the Treasury
Office of Government Financing

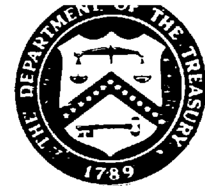
March 24, 1982



Office of the Secretary of the Treasury
Office of Government Financing

March 24, 1982

TREASURY NEWS



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

FOR RELEASE UPON DELIVERY
March 30, 1982

STATEMENT BY
ROBERT E. POWIS
DEPUTY ASSISTANT SECRETARY FOR ENFORCEMENT
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON CRIME
HOUSE COMMITTEE ON THE JUDICIARY

Mr. Chairman and members of the Subcommittee:

It is my pleasure to appear before you today in response to your request of the Treasury Department to supply information about bullets capable of piercing soft body armor and the so-called "Devastator" bullet. I am accompanied this morning by Mr. Edward M. Owen, Chief of the Firearms Technology Branch and Mr. Alfred C. Johnson, Senior Firearms Examiner of the Forensic Science Branch, Bureau of Alcohol, Tobacco and Firearms. Also with me is Special Agent Gary McDermot from the U.S. Secret Service. These gentlemen will be in a position to answer technical questions which you may have regarding armor-piercing ammunition.

The Department shares the concern of the Committee and of a large number of people who also expressed concern following recent publicity surrounding a TV program regarding the "KTW" armor-piercing bullet. Although armor and ordinance experts have been aware that there has been in existence for a number of years many types of handgun ammunition capable of penetrating soft body armor, criminals and persons who would cause harm to others were generally unaware of this situation until the exposure on the television program and the resulting publicity.

The immediate reaction of most people after the publicity was that this bullet must be banned. People at all levels in and out of government voiced a feeling that legislation should be passed or regulations promulgated that would make the manufacture and possession of these and similar bullets illegal. There was a feeling that this would cure the problem. I would submit for the Subcommittee's consideration that the issue is far more complex than meets the eye and that there are no easy answers.

A number of practical problems arise in attempting to legislate against the importation, manufacture or sale of armor-piercing ammunition. I would like to apprise you of the significant problems we see in this effort. An attempt to define projectile-type ammunition as H.R. 5437 would seek to do, invariably includes a wide range of ammunition commonly used for hunting, target shooting or other legitimate and long-established sporting purposes. The task is further confounded by the fact that soft body armor is not designed to repel any and all armor-piercing bullets. This is a very important fact and is worth repeating. Soft body armor is not designed to repel any and all handgun bullets. It should also be noted that serious injury can and does occur even though a bullet fails to penetrate armor. This is by shock transmitted through the vests into the body and may, in a given situation, be more serious than a bullet wound. Mr. Chairman, in my testimony today I do not intend for obvious reasons to identify the numerous speciality cartridges which have the ability to penetrate soft body armor.

I would like to point out that we have difficulty with the terminology of H.R. 5437 which would restrict handgun bullets rather than complete cartridges. This is impractical because the performance of a bullet or projectile is dependent upon a number of factors including the quantity and type of propellent power used to assemble the bullet into a cartridge. The performance of a bullet which will not penetrate armor can be changed by varying the quanity and/or type of propellent, so that the same bullet will indeed penetrate armor. Legislation or regulations which attempt to address this problem should deal with complete cartridges rather than mere bullets or projectiles.

While the intent of the bill is to proscribe ammunition such as "KTW" which will penetrate bullet-resistent vests and apparel, it would, as previously stated, be likely to include other ammunition readily available in commercial channels

which is not designed or intended to penetrate soft body armor. Many handguns currently produced fire rifle-type ammunition. It is likely that much sporting rifle ammunition when fired from a 5-inch barrel, would penetrate soft armor. Therefore, under H.R. 5437, all cartridges for which a handgun is made would have to be tested. This would be a monumental task. Many sporting rifle cartridges would end up being restricted by this bill. Even though regulations may be prescribed which will list certain restricted ammunition, the physical identification of the restricted ammunition, as opposed to similar cartridges which are not restricted, would be very difficult. The testing of ammunition contemplated by the bill would be burdensome because virtually all ammunition would need to be tested. Additionally, the bill would mandate the testing of all foreign ammunition imported into the United States. The changing of ammunition designs would create an additional burden under the bill by mandating continuous testing.

The purpose of H.R. 5437 may be thwarted if ammunition, which although tested and determined to be non-armor piercing, is used in firearms having a barrel length exceeding that of the test weapon. A longer barrel can cause increased muzzle velocity, which in turn, can give a projectile from a non-restricted cartridge the ability to penetrate soft body armor.

In response to the Subcommittee's question as to how quickly regulations implementing H.R. 5437 could be issued, we are uncertain as to how much time would be required to reach the point where proposed regulations would be appropriate. In preparation for prescribing regulations listing restricted ammunition, a testing procedure must be established, equipment must be obtained, test fixtures would have to be constructed, and the acquisition of additional specialized space may be necessary. In addition, barrels in all needed calibers for virtually all kinds of ammunition would have to be acquired, as well as the ammunition to be tested. Moreover, it would be necessary to consult outside experts to develop test procedures and equipment before regulations are proposed.

Based upon the above, it would probably be six months, perhaps longer, before regulations could be proposed to implement H.R. 5437. Once proposed, the regulation process usually takes 60 to 120 days to complete. This includes a

comment period, generally 60 days, and time for evaluating comments, review of the proposed regulation, and issuance of the final regulation. It is our judgment that the end product would be difficult to achieve, would include many cartridges that are commonly used for sporting purposes and would invariably fail to include certain cartridges that could, under certain different conditions, be able to penetrate soft body armor.

With respect to "Devastator" or other exploding bullets we cannot conclude at this point in time that this ammunition poses any more of a serious problem or threat than other types of ammunition. However, the Subcommittee may be interested to know that small arms projectiles containing explosive materials designed to explode on impact already are regulated under existing law administered and enforced by the Department and ATF. Aside from the fact that the ammunition is subject to regulation under the Gun Control Act, the explosive ingredients of such ammunition constitute "explosive materials" under Title XI of the Organized Crime Control Act of 1970 (18 U.S.C. Chapter 40). Among other things, Title XI requires licensing of those engaged in the business of importing, manufacturing and dealing in such materials and permits for others who ship, transport, or receive explosive materials in interstate commerce. In other words, a dealer in exploding bullets must be licensed under Title XI and may only distribute the ammunition in interstate commerce to other licensees or permittees. Furthermore, these materials must be stored safely and securely in conformity with Federal regulations. Although "small arms ammunition" is exempt from regulation under Title XI, "Devastator" bullets do not constitute exempt ammunition since their high explosive ingredients are not treated as small arms ammunition components.

In the Secret Service, protective armor is not viewed as a panacea for the inherent dangers associated with Secret Service protective and investigative responsibilities. It is merely a tool to help reduce the incidence of injury to a person being protected or an employee of the Secret Service in the event that all other security measures fail.

The Service depends primarily on security arrangements made prior to the visit of the protectee to prevent injury to that protectee, i.e., intelligence gathering, physical security, check points, locks, special lighting, explosives detection, counter-sniper support, magnetometers, etc. The Service has

recognized for a long period of time the fact that soft body armor is not designed to defeat all handgun cartridges.

Intelligence regarding utilization or possession of armor-piercing bullets by terrorists groups is classified information. I would like to suggest, Mr. Chairman, the information in this matter be handled in Executive Session.

Mr. Chairman, let me conclude by stating in summary that we are not certain that this legislation - H.R. 5437 - will be effective in proscribing ammunition which can penetrate soft body armor. We do have a concern about the availability of armor-piercing ammunition in the hands of people who want to harm others. With this in mind, the Treasury Department has contacted several manufacturers of some of the more commonly known armor-piercing bullets used primarily in handguns. We have asked these manufacturers to voluntarily restrict their sales to legitimate law enforcement organizations at the Federal, state and local level and to the armed services. We have asked them not to make sales to Federal firearms licensees. The response so far has been excellent. I do not suggest that this is a full solution to this problem. However, we believe that it is a step in the right direction. In the meantime, we are continuing to explore with the Justice Department other legislative alternatives. We will, of course, report to the Committee if and when we are better able to deal with this issue by means of legislation.

We have also been asked to comment on H.R. 2280 and H.R. 5392, which are bills authorizing the Secretary of the Treasury to conduct a study of handgun ammunition manufactured in, or imported into the United States, to determine which have the capacity to penetrate bullet-proof vests commonly used by most enforcement officers. There were previous studies conducted by the Department of the Army for the Department of Justice at the cost of approximately $1.4 million. From these studies and others and from the knowledge and expertise which exists in law enforcement at the Federal, state and local levels, we know of a number of bullets which have the capacity to penetrate bullet-proof vests. The problem arises, as indicated above, in the effort to define what it is we wish to prohibit. We have doubts about the value of these bills in light of information already known and whether or not the amount of $500,000 would be sufficient to do a worthwhile study if another one is indeed needed.

At this time, Mr. Chairman, I or one of my associates from ATF and the Service would be pleased to attempt to answer any questions which you or the members of the Subcommittee might have.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. March 30, 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 $9,400 million, to be issued April 8, 1982. This offering will result in a paydown for the Treasury of about $ 75 million, as the maturing bills are outstanding in the amount of $ 9,479 million, including $ 1,065 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $ 1,479 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 $ 4,700 million, representing an additional amount of bills dated January 7, 1982, and to mature July 8, 1982 (CUSIP No. 912794 BD 5), currently outstanding in the amount of $4,929 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $ 4,700 million, representing an additional amount of bills dated October 8, 1981, and to mature October 7, 1982 (CUSIP No. 912794 AZ 7), currently outstanding in the amount of $ 5,251 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 April 8, 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, April 5, 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 three decimals, e.g., 97.920. 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 April 8, 1982, in cash or other immediately-available funds or in Treasury bills maturing April 8, 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 March 30, 1982

RESULTS OF TREASURY'S AUCTION OF 20-DAY CASH MANAGEMENT BILLS

Tenders for $ 8,016 million of 20-day Treasury bills to be issued on April 2, 1982, and to mature April 22, 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 -	99.198	14.436%	14.75%
Low -	99.189	14.598%	14.92%
Average -	99.192	14.544%	14.87%

Tenders at the low price were allotted 82%.

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

Location	Received	Accepted
Boston	$ 40,000	$ --
New York	28,500,000	6,941,700
Philadelphia	--	--
Cleveland	--	--
Richmond	40,000	20,000
Atlanta	--	--
Chicago	1,645,000	407,300
St. Louis	10,000	2,640
Minneapolis	12,000	--
Kansas City	35,000	25,000
Dallas	--	--
San Francisco	1,355,000	619,000
TOTALS	$31,637,000	$8,015,640

R-708

TREASURY NEWS

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

For Release Upon Delivery
Expected at 9:00 a.m. EST
March 31, 1982

STATEMENT OF
THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON ENERGY, ENVIRONMENT AND SAFETY
OF THE
HOUSE SMALL BUSINESS COMMITTEE

Mr. Chairman and Members of the Subcommittee:

I am here today to discuss the views of the Treasury Department on guarantees by the Small Business Administration (SBA) of tax exempt industrial development bonds issued to finance pollution control facilities.

The Treasury Department opposes SBA guarantees of tax exempt pollution control obligations. In addition, the Administration is now proposing that Congress enact additional restrictions on all types of private purpose tax exempt bonds. Before commenting upon our particular concerns with respect to pollution control obligations and the SBA program, I would like to review some of the factors that have caused us to conclude that additional limits are needed on all types of private purpose tax exempt bonds.

There has been a virtual explosion in the last five or six years in the issuance of private purpose tax exempt obligations. This includes bonds issued for single family housing, student loans, and nonprofit hospitals and colleges as well as industrial development bonds (IDBs). More than $25 billion were issued in 1981, up from $8.5 billion in 1976. Private purpose bonds accounted for 24 percent of the long term tax exempt bond market in 1976, but rose to 48 percent in 1981. The Treasury Department estimates that 55 percent of the tax exempt bonds sold in 1982 will be for private activities. The volume of tax exempt pollution control obligations issued for private businesses was $3.8 billion in 1981, representing approximately 7 percent of the entire long term tax exempt market, and will be an estimated $4.2 billion in 1982.

The largest growth has occurred in small issue IDBs, which allow virtually any business to obtain tax exempt financing for land or depreciable property. Small issue IDBs have been used extensively by the largest corporations in the country. For example, one of the largest retailing chains has used small issue IDBs to finance $240 million of facilities since 1976. Small issue IDBs marketed in 1981 were an estimated $10.5 billion of the total $25 billion of private purpose bonds. Small issues represented 20 percent of the entire long term tax exempt market in 1981, as compared with only 4 percent in 1976. The estimated revenue loss to the Federal Treasury from small issue IDBs alone will be $1.65 billion in fiscal 1982 and will exceed $2.1 billion in fiscal 1983 unless additional restrictions are imposed. Moreover, we estimate that less than 15 percent of the new investments made in 1981 that were eligible for small issue IDB financing were in fact financed by that method. This means that the potential for future growth in the volume of small issue IDBs remains enormous.

The proliferation of private purpose tax exempt bonds -- along with reduced demand for tax exempt bonds by institutional investors and the tax rate reductions and other structural tax changes enacted in the Economic Recovery Tax Act -- has contributed to a significant narrowing of the difference in interest rates between tax exempt and taxable bonds. While the tax exempt rate historically has been about 65 to 75 percent of the taxable rate, issuers of tax exempt bonds currently have to pay about 80 to 85 percent of the taxable rate. This erosion of the relative advantage of tax exempt financing has increased significantly the interest costs incurred by state and local governments in financing essential public services and facilities.

The increasing volume of private purpose tax exempt bonds has also caused mounting Federal revenue losses. We estimate that the total Federal revenue loss from private purpose tax exempt bonds outstanding in fiscal year 1981 was $3.22 billion and will be $4.19 billion for fiscal 1982.

The proliferation of tax exempt bonds has made them less cost-effective as subsidy mechanisms for private activities. Tax exempt financing has often been criticized as an inefficient means of granting Federal subsidies. The revenue loss to the Treasury from the income tax exemption is significantly greater than the interest cost savings to users of the bond proceeds. For example, if we assume that an investor in the 40 percent bracket purchases a bond bearing interest at 70 percent of the taxable rate, the Treasury loses $1.33 for every $1.00 of interest savings to the bond user. Even more of the benefit is siphoned off by investors as tax exempt bond rates grow closer to taxable rates, as they have recently.

These and other considerations have caused us to conclude that additional restrictions are needed to reduce the growth of private purpose tax exempt obligations. The specific details of our proposal are described in the general and technical explanations released by the Treasury Department on February 26. Copies of those explanations are attached to this statement.

The special provision for small business under our proposal relating to small issue IDBs should be of particular interest to this Subcommittee. Under the Administration's proposal, small issue IDBs will be retained for businesses that have capital expenditures of less than $20 million over the 6-year period from 3 years before to 3 years after the issuance of the bonds. In addition, no single firm will be able to have over $10 million of IDB-financed facilities at any one time. However, subject to these restrictions, small issue IDBs could be marketed as a part of a composite or umbrella bond issue. These changes will make it easier for small and medium-sized businesses to use small issue IDBs and will prevent the use of small issue IDBs by large corporations that are able to raise funds readily in capital markets without an interest subsidy from the Federal government.

I would now like to discuss the policy considerations relating specifically to tax exempt financing for pollution control facilities and the SBA guarantee program.

It is often argued that Federal assistance for construction of pollution control facilities is justified because pollution control requirements are special burdens imposed on businesses by government. However, in our view the cost of controlling pollution should be regarded as part of the cost of producing goods and should be reflected in market prices. The consumption of goods produced by techniques that create air or water pollution as a by-product will be excessive if the market prices of those goods do not reflect all production costs. Thus, providing tax exempt financing for investments in pollution control facilities produces undesirable economic distortions, in that it results in a higher level of investment in polluting industries and a lower level of investment in other economic activities. Another result of the subsidy is that part of the cost of controlling pollution is borne by taxpayers in general, rather than by the purchasers of the goods produced.

Tax exempt financing for pollution control facilities also has been justified in the past by the need to assist businesses in bringing existing plants into compliance with new pollution control requirements. Now, however, most pollution control bonds are issued to finance pollution control facilities for new plants rather than existing plants. Thus, the "transition rule" argument for the tax exemption is no longer applicable in the majority of cases. Furthermore, it is difficult in many cases to determine what portion of a newly constructed plant constitutes pollution control facilities, particularly if the plant employs new or innovative processes or equipment rather than facilities of a type that have previously been recognized as qualifying for tax exempt financing. This inevitably creates an undesirable bias against new technology and in favor of particular types of pollution control equipment which are recognized as eligible for tax exempt financing.

Providing Federal guarantees for tax exempt obligations raises additional problems. Placing the credit of the United States behind an obligation that is exempt from Federal taxation creates a security which is superior in the market to the direct obligations issued by the Federal government. A Federally guaranteed tax exempt obligation also has a distinct competitive advantage over all other tax exempt obligations issued by State and local governments. As a result, Federal guarantees of tax exempt obligations increase the borrowing costs of Federal, State and local governments. Because of these and other considerations, the Treasury Department has consistently opposed Federal guarantees of tax exempt obligations. Moreover, the Public Debt Act of 1941 prohibits the Federal government from issuing tax exempt obligations directly; and numerous other statutes preclude Federal guarantees of tax exempts in other contexts. Allowing SBA guarantees of tax exempt pollution control obligations would be directly contrary to the policies expressed by Congress in those enactments.

Finally, in these times of budgetary constraint, we believe that SBA guarantees of tax exempt obligations would represent an unwarranted duplication of Federal benefits. Both the SBA guarantee and the income tax exemption are implicit subsidies that reduce the interest rate that borrowers must pay. In view of the pressures on the tax exempt bond market and the inherent inefficiencies involved with using tax exempt financing as a subsidy mechanism, we believe that it is appropriate for the Small Business Administration to restrict its guarantee program to taxable financings.

I will be happy to answer your questions.

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)		Annual Rate of Growth Between 1976 & 1981 (In Percent)
	1976	1981	
Housing	$3.0	$6.9	18%
Private Hospitals	1.9	3.5	13
Student Loans	0.1	1.0	58
Pollution Control	2.1	3.8	13
Small 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.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
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Contact: Mary Boswell Watkins
566-2041

SECRETARY REGAN SUBMITS GOLD COMMISSION REPORT TO CONGRESS

Treasury Secretary Donald T. Regan today submitted the report of the Gold Commission to the President of the Senate and the Speaker of the House of Representatives.

The U.S. Congress directed the establishment of the Gold Commission in Public Law 96-389 in order to assess the role of gold in the domestic and international monetary systems and to study the U.S. policies related to gold. Secretary Regan chaired the Commission which included seven members of Congress, three members of the Board of Governors of the Federal Reserve System, two members of the Council of Economic Advisors and four distinguished private citizens. The Commission held its first of nine meetings on July 16, 1981, and thereafter met on approximately a monthly basis. Twenty-three witnesses presented testimony at two of these meetings. In addition, a number of written points of view were submitted by members of the public.

The report consists of an Introduction, which includes the Commission's recommendations, and four chapters. Six members of the Commission drafted minority statements in order to clarify their views, and these appear in an annex of the report. Another annex contains written statements that the public was invited to submit.

The report may be obtained from the Superintendent of Documents, U.S. Government Printing Office, Stock Number 048-000-00353-2, Phone Number (202) 783-3238. The detailed records of all Commission proceedings, including meeting transcripts, written testimony, staff memoranda and all papers circulated to the Commission, are catalogued in an annex to the report and are available for public inspection at the Library of Congress, the National Archives and Records Service, and the Treasury Department library.

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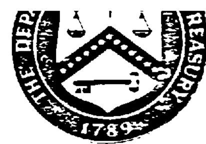
TREASURY NEWS



epartment of the Treasury • Washington, D.C. • Telephone 566-204

STATEMENT BY
DONALD T. REGAN
SECRETARY OF THE TREASURY
GOLD COMMISSION
WEDNESDAY, MARCH 31, 1982

As Chairman of the Gold Commission, I have submitted today the report of the Gold Commission to the President of the Senate and the Speaker of the House of Representatives.

Although the Commission concluded essentially that it did not favor a renewed role for gold at this time, it has recommended that the Treasury issue gold bullion coins of specified weight without dollar denomination or legal tender status, and to be exempt from capital gains and sales taxes.

In domestic policy, the majority concluded that, under present circumstances, restoring a gold standard does not appear to be a fruitful method for dealing with the continuing problem of inflation.

In international policy, the majority concluded that it favored no change in the use of gold in the operation of present exchange rate arrangements.

Other specific findings and recommendations regarding the U.S. Government's policy towards the role of gold in the domestic and international monetary systems are presented in this report. These recommendations represent the views of the majority of the Commission. Minority views or recommendations have been included where appropriate.

In many instances, the members of the Gold Commission had differing opinions on the questions raised. This was evident in the lively discussions we had and the many position papers that were written. In spite of the diversity of the group, however, the report represents the product of the Gold Commission as a whole.

I would like to take this opportunity to thank my colleagues for devoting so much of their time to serve on the Commission. I would also like to thank the many individuals who testified before and submitted written statements to the Commission.

It has been an honor for me to have chaired this Commission and to have contributed in this capacity.

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TREASURY NEWS

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FOR RELEASE UPON DELIVERY
Expected at 9:30 A.M., EST
Thursday, April 1, 1982

STATEMENT OF
THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
COMMITTEE ON APPROPRIATIONS
OF THE HOUSE OF REPRESENTATIVES
APRIL 1, 1982

Mr. Chairman and Members of the Committee:

Thank you for giving me this opportunity to address you.

Mr. Chairman, under your able leadership and that of Jack Kemp, Members of this Subcommittee were able to set aside differences last year in order to enact the first foreign assistance bill in three years and, in the process, further U.S. foreign policy interests.

I know the President appreciates what you did. For my part, I admire your achievement.

Mr. Chairman, I remember from our hearing last year that you and your Committee prefer to have a give-and-take in your hearing rather than to listen to a lengthy prepared statement. I prefer that myself.

With your permission and since Marc Leland, my Assistant Secretary for International Affairs, has already presented our FY 83 request, I will share with you a few ideas which reflect my perspective on the MDBs.

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First, with regard to our budget request which -- as you know -- calls for increased funding for the MDBs, I would stress three points:

-- The largest part of the request is based on previously negotiated international agreements. The President has stressed the importance of living up to these agreements.

-- The main reason for an increase in the request is the proposed addition of $245 million for IDA -- an increase which is directly traceable to this Administration's decision to reduce contributions in the early years of the sixth replenishment within the context of fulfilling our commitments under the agreement.

-- In the longer term, the trend of our contribution is down. By FY 85, when the replenishments will have been largely negotiated by this Administration, we plan total appropriation request levels of about $1.2 billion annually.

Since becoming Secretary, I have met regularly with my counterparts from Japan, Germany, France, and Great Britain. The MDBs represent one of the most visible and concrete examples of allied cooperation in international economic relations -- not just cooperation for cooperation's sake, but because these institutions serve our common interests.

Our common long term goal is to build and maintain an international economic system that is open, growing and characterized by increased efficiency and output. We hope and expect that such a system will encourage the development of democratic, pluralistic and free market societies, such as ours.

As you know, since last year Treasury has conducted an assessment of the MDBs. Our assessment leads us to the conclusion that the MDBs can act as catalysts in the international economic system and, indeed, references to encouraging private investment and international trade are embedded in the Charters of these institutions.

We can see an example of the catalytic role the MDBs can play close to home and in strong support of U.S. foreign policy goals. The World Bank and Inter-American Development Bank chair consultative groups for the Caribbean and Central America, respectively, which will contribute to the President's Caribbean Basin Initiative. While providing a forum for donor coordination, the MDBs are also expected to provide development assistance in the range of $700 to $800 million annually to the region.

In addition to these traditional roles of donor and coordinator, a critically important goal of the MDBs in the future will be to encourage the private sector to invest its own capital and expertise in sound projects. It is in this role, as a catalytic agent in the enhancement of entrepreneurship, investment capital and production, that the MDBs can make a significant contribution to economic development.

A fair question is how can the Administration be proposing both a reduction in our contributions to the MDBs and continued growth in lending levels.

We are convinced that the MDBs can use their resources more effectively. First, by exercising greater selectivity in providing loans, the MDBs can channel financing to those countries that have adopted sound micro and macro economic policies. Financing for countries pursuing ineffective policies should be curtailed, and, if circumstances dictate, terminated.

Second, the MDBs should adopt effective policies to "graduate" countries from the hard windows, when these countries have advanced to the point that they can rely fully on private capital flows. Similarly, countries that have achieved the requisite level of creditworthiness, such as India, should "mature" from the soft loan windows and should borrow from the hard loan windows.

By pursuing these two policies, we can ensure that scarce resources are concentrated on those countries which can best employ them and which are in the greatest need. And we can obtain more cost-effective development financing from the MDBs, while limiting budgetary outlays.

The ability of the MDBs to support sound programs will be expanded and enhanced by catalyzing private capital through cofinancing and by working more closely with private investors.

Treasury's assessment found indications that past overemphasis on lending targets had eroded MDB effectiveness in encouraging sound economic policies.

This is changing. Our message is getting through loud and clear:

-- The World Bank is implementing rigorously its graduation and maturation policies for the first time in many years.

-- The United States has worked hard in the IDB to encourage minimum standards for realistic user charges in power and transport projects. These user charges will be designed to cover operating and capital costs of these services.

-- The United States will no longer passively support loans to countries pursuing ineffective economic policies. We vetoed our first loan in the Fund for Special Operations, opposed several other MDB loans for economic reasons and stand ready to oppose misdirected loans again in the future.

During the course of this year, the Administration will be negotiating replenishments for the hard and soft loan windows of the Inter-American Development Bank and the Asian Development Bank. We plan to participate fully in these replenishments, but we will insist on realism and restraint in future lending programs. Before this Administration makes any commitments, there will be thorough consultations with Members of this Committee and other interested Members.

I understand that Members of this Committee have expressed a strong preference for continuing to include the requirement for paid-in capital in the Inter-American and Asian Bank capital increases.

The Administration believes that reduction or elimination of paid-in capital would reduce the budgetary cost of U.S. participation in the MDBs.

Reduced levels of paid-in capital would have the effect of bringing MDB lending interest rates closer to market levels and of shifting the program cost from non-borrowing shareholders to borrowers, since interest-free paid-in capital would be replaced by borrowing from capital markets to support lending programs.

Our analysis indicates that the impact on the financial integrity of the MDBs would be minimal and would be offset by relatively modest increases in financial charges.

The Congress would retain full control over callable capital subscriptions to the MDBs. No U.S. subscriptions to callable capital could be made without approval by the Congress in authorizing and appropriations legislation. Callable capital subscriptions could only be made to the extent that the Congress provides for program limitations in appropriations acts.

However, I want to stress today that during the course of this year's negotiations, we will keep the Committee's views in mind and intend to continue consultations with this Committee and other interested Members on this issue.

Some have asked how can we maintain sufficient influence to implement our policies when we are limiting our contributions to the MDBs.

The United States remains the largest contributor to the MDBs, and our leadership position ensures that our views will be given serious consideration. We believe our recommendations are sound and that they reflect not only our national interests, but the common interests of the democratic, capitalist countries, who provide the major share of resources to these institutions. We are committed to pursuing actively recommendations in our assessment and to continuing to be a reliable financial supporter of the MDBs.

These factors provide solid foundations for anticipating continued strong influence in these institutions.

Last year, this Committee strengthened the Administration's hand in the MDBs by providing the first foreign assistance appropriations act in three years. You deserve the credit for some of the changes we are seeing in the MDBs.

I hope we can continue to rely on your support this year, because working together we can shape the MDBs into effective and vigorous proponents of market-oriented economic growth.

TREASURY NEWS

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FOR IMMEDIATE RELEASE March 31, 1982

RESULTS OF AUCTION OF 7-YEAR NOTES

The Department of the Treasury has accepted $3,253 million of $6,142 million of tenders received from the public for the 7-year notes, Series D-1989, auctioned today. The notes will be issued April 7, 1982, and mature April 15, 1989.

The interest coupon rate on the notes will be 14-3/8%. The range of accepted competitive bids, and the corresponding prices at the 14-3/8% coupon rate are as follows:

	Bids	Prices
Lowest yield	14.38% 1/	99.957
Highest yield	14.45%	99.655
Average yield	14.42%	99.784

Tenders at the high yield were allotted 40%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 26,066	$ 13,066
New York	5,206,397	2,816,847
Philadelphia	21,300	14,700
Cleveland	40,710	25,710
Richmond	37,134	34,834
Atlanta	25,086	24,586
Chicago	510,775	137,175
St. Louis	61,317	54,017
Minneapolis	12,882	12,562
Kansas City	17,691	17,686
Dallas	10,051	10,051
San Francisco	171,291	90,691
Treasury	1,278	1,278
Totals	$6,141,978	$3,253,203

The $3,253 million of accepted tenders includes $535 million of noncompetitive tenders and $2,718 million of competitive tenders from private investors.

In addition to the $3,253 million of tenders accepted in the auction process, $75 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

1/ Excepting 1 tender of $10,000.

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TREASURY NEWS

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FOR IMMEDIATE RELEASE

REMARKS BY THE HONORABLE JOHN M. WALKER, JR.
ASSISTANT SECRETARY (ENFORCEMENT AND OPERATIONS)
DEPARTMENT OF THE TREASURY
BEFORE THE CONNECTICUT BUSINESS INDUSTRIES ASSOCIATION
AND CONNECTICUT CHAMBER OF COMMERCE
AT THE ANNUAL CONNECTICUT BUSINESS DAY CONFERENCE
LIBRARY OF CONGRESS
THURSDAY, APRIL 1, 1982

As one whose home for 18 years was in Connecticut, it gives me great pleasure to speak to you tonight. As both neighbor to New York City and gateway to New England, Connecticut provides a fine mix of values which are manifested in its business life -- a dynamic, farsighted approach to business tempered by old-fashioned Yankee realism.

I should also add that few states equal the Nutmeg state in physical beauty -- from Sharon and Lakeville in the Northwest to Mystic in the East. And your institutes of higher learning -- including one in New Haven where I spent four years -- are second to none. In sum, you have chosen a great place to work, to live and to raise your families.

Connecticut has changed a lot since I was a boy in Fairfield County in the early 1950's, as has the nation. In fact, the pace and scope of change during recent years is sufficient to validate the observation by the Greek philosopher Heraclitus who said, "Nothing endures but change." What the philosopher neglected to say was that change occurs either by chance or by choice. It is that last factor -- change by choice -- that is the subject of my remarks this evening.

One of the most signifcant choices by the American people was made more than a year ago with the election of Ronald Reagan. That was when the electorate said, "enough" -- enough of erratic

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economic policies -- enough of inflation -- enough of tax rates that penalize incentive and discourage investment -- enough of government that hinders productivity by absorbing resources from the private sector -- and enough of government that sacrifices initiative on the altar of regulation. The electorate voted for change.

In making that choice, the American people did not merely swap one Administration for another, or place a new tenant in the White House; they demanded a new course in the affairs of the nation.

The new course we have plotted is for the long term. It is intended to produce sustained economic growth, and it will. It is intended to produce jobs -- and it will. It is intended to produce lower interest rates -- and it will. These are the objectives that the Administration sought when it first devised its program for economic recovery.

That program emerged from a series of choices. We could have chosen to seek a balanced budget on the backs of the taxpayers; we chose instead to cut back the growth of government spending.

We could have allowed inflation to increase Federal revenues; we chose instead to cut personal tax rates and index them.

We could have chosen the quick fix of inflating our way into prosperity; we chose instead to encourage the Federal Reserve in a policy of slow, steady growth in the money supply.

Finally, we chose to reduce regulatory intrusions into the marketplace; and we are well on our way to success in that effort.

The cumulative effect of all those choices is a policy that has begun to turn the economy back to the producers of this country -- to those who can generate growth, and jobs, and real wealth. And we have begun to see some of the results of that policy.

For the first time in seven years, inflation has actually declined. Some say this is an anomaly -- a transitory phenomenon.

If this is true, we believe that there will be more of those phenomena in the months ahead -- more indicators of progress toward our goal of strong, real economic growth.

For example, for the first time in years, union contract settlements are beginning to reflect -- at least in part -- the lowering of inflationary expectations. That has been manifest most recently in the automobile industry. Those settlements are important portents of declining inflation.

We are rapidly approaching a new economic environment. And, if we have not as yet broken the back of inflation, we at least have it pinned to the mat.

And inflation will stay pinned even during the economic recovery that is beginning to emerge.

In spite of the continued decline in the current quarter, there are some hopeful signs. Excess inventories are being drawn down at a rapid rate. This is typical of the last stages of a recession. Retail sales are rising. Housing starts are up slightly, and durable goods orders have leveled off.

Granted, as Aristotle said: "One swallow does not a summer make." And one or even two positive indicators does not make a recovery. Nevertheless, as spring continues, we will see more swallows in the form of positive indicators, and we will come into the summer with the recovery under a full head of steam.

All this, of course, is predicated on prompt, deliberate Congressional action on President Reagan's budget. Adlai Stevenson once said: "...there are no gains without pains." This Administration made the tough choices that went into our budget proposal.

Now it is time for Congress to accept its portion of pain, and make the fiscal choices that will stimulate economic growth and maintain the nation's security. The Administration would welcome bipartisan alternatives that do not try to balance the budget on the backs of the taxpayers, or impede our ability to defend the nation.

We understand the misgivings of members of Congress and others who are worried about budget deficits.

Let us be clear from the outset; this Administration is deeply troubled by deficits. Like taxes, deficits finance excessive government spending and absorb resources better left in the private sector. We are opposed to them as a matter of principle, and intend to see a budget in balance ultimately.

But the deficit must be put in some perspective; it cannot be viewed in isolation from the rest of the economy. Granted, viewed in isolation and in terms of sheer dollars, the projected budget deficit is the largest in our history.

But that does not hold true if you put the deficit in the context of the total economy. For fiscal 1983, we are projecting a deficit that amounts to 3.1 percent of the gross national product. The fiscal 1976 deficit amounted to 4.5 percent of the gross national product.

In fact, a number of other industrial nations during the last several years have consistently posted deficits greater than ours when compared to their gross national products. And I include among them West Germany, Japan, Italy and the United Kingdom.

Our budget deficit for 1981 amounted to 2 percent of our gross national product. This compares, by the way, with West Germany - 4.8 percent; Italy - 9.4 percent; the United Kingdom - 5.0 percent and Japan - 3.6 percent. Indeed, Japan has in the past run a deficit as high as 5.5 percent of its GNP.

Nevertheless, Japan's experience with inflation, interest rates and real growth stands in marked contrast to ours. The reason is primarily its stable monetary policy and high rate of saving. In 1980, for example, gross saving as a percentage of Japan's GNP was a little more than 30 percent. Our gross saving rate, on the other hand, was 18.3 percent, slightly more than half that of Japan.

Deficits must be financed, either by borrowing a portion of national savings, or by inflationary money creation. Japan has a high enough savings rate to finance a deficit with enough savings left over for investment and growth without rapid money creation. Consequently, Japan's inflation rate and interest rates have remained low.

The U.S. on the other hand has done too little saving and allowed too much money creation over time. The result has been slow growth, rapid inflation and high interest rates. We intend to change that.

Increasing the rate of saving in the United States has been one of our major objectives. We believe that goal has been achieved, and that as a result, private saving will be several times the total borrowing requirement of the Federal Government in fiscal 1983 and fiscal 1984.

If current and projected deficits are symptomatic of anything, it is a lack of economic growth to date.

We believe the best way to balance the budget, while raising living standards, is through economic growth that enlarges the tax base. We want to see growing payrolls that

will contribute to Federal revenues, not higher taxes on a declining number of workers and businesses.

The Congress has tried time and time again to balance the budget with tax increases. And it has not accomplished the objective.

Between 1974 and 1981, despite several legislated tax reductions, overall Federal tax receipts rose $338 billion; yet we still accumulated deficits of $350 billion; and today have a national debt in excess of a trillion dollars.

Raising taxes does not balance budgets. Tax increases simply give the Federal Government more to spend on Federal programs that create constituencies for yet more spending.

Postponing the tax cuts, or eliminating them altogether, would transform a tax program oriented toward work, saving and productivity into just another attempt to fine tune the economy.

If, as Francis Bacon said, "History makes men wise," then we would do well to learn from past attempts to attack deficits through tax increases rather than spending cuts. The Federal Government imposed a surtax of 7.5 percent in 1968, 10 percent in 1969 and 2.5 percent in 1970.

And from late 1969 to late 1970, real gross national product declined 1 percent and unemployment almost doubled. But more to the point, the deficit -- from being marginally in balance in 1969 -- grew to $23 billion in 1971. The tax increases reduced saving, investment and gross national product, and led to a higher deficit.

If anything, that marginal balance of $3.2 billion in the 1969 budget was an exception that proved the rule: Taxes will not balance the budget, they simply bloat the Government.

You know, I know and every taxpayer knows that, if you send money to Washington, they will find a way to spend it. If you want to stop the child from eating the cookies, you have to take away the cookie jar.

That is what we did when we cut tax rates. Now the free spenders in Congress are complaining about deficits. They are trying to conceal their real desires for more taxes and more spending -- more cookies.

That fact is plain to anyone who has paid attention to Washington during the last two decades. It is a fundamental principle that Congress will spend everything it takes in -- and then some.

Another principle of Congress is this: It is impossible to limit action on the tax code once Congress opens it up to change.

Their legislative axe will fall on much more than just the third year of the tax cut. It will very likely fall on other targets -- the cut in the tax on unearned income from seventy to 50 percent, for example, or the reduction in the long-term capital gains tax to 20 percent.

I trust that no one here is naive enough to believe that Congress will eliminate or postpone personal tax relief, and leave other aspects of the tax program untouched.

And if the maximum tax on unearned income and the 20 percent tax on long-term capital gains are increased -- and they very well could be -- you can kiss much of the strength in the new issues market goodbye.

The program we have in place should stay in place.

Tampering with the tax program in the name of balancing the budget would send a clear, unmistakable message to the economy -- a message that would say, "We are back to business-as-usual -- back to the old stop-and-go policies."

That message will confirm the market's belief that the government -- specifically the legislative branch -- is incapable of taking the long-term actions necessary for real growth. And that belief in turn will keep interest rates high.

So now we come to the current crux of the economic problem -- high interest rates. Looked at from Treasury's vantage point, there is little reason for rates to be as high as they are.

The more we search for a reason for current interest rates, the more we are reminded of the young Irish girl who went to Confession.

She told the kindly old curate that she was afraid she might have committed the sin of vanity.

"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 afraid. That's not a sin. It's a mistake."

Today's interest rates are no laughing matter.

After all, real interest rates have historically run 3 or 4 percent above the inflation rate. But in recent years,

layered on top of real rates, have been added premiums for uncertainty and for the expectation of future inflation.

Those premiums were understandable in the climate of inflation that existed before this Administration took office. Clearly, today there is little reason for adding a premium for inflation -- at least not at the levels that exist today.

How much does it take to convince the markets that the Government is seriously committed to slow, steady growth in the money supply, to not monetizing the debt, and to restoring the economy to a non-inflationary course?

Think about this for a moment; Federal borrowing this year will take about 22 percent of the funds in the credit market.

In 1975, the Government preempted 42 percent of the credit available and interest rates were declining.

In light of this year's relatively minor pressure on the credit markets, one can only conclude that real interest rates of 7 or 8 percent -- if not unconscionable -- are at least paradoxical.

I am sure that in time that paradox will be resolved as we move toward a growing economy -- one without the torments of inflation -- one that affords every one the prospect of prosperity.

In the final analysis, problems of economic policy are human problems. Behind the cold numbers issued by the Bureau of Labor Statistics are people and families who ask only the opportunity to put their skills to work in some productive endeavor.

We understand that human dimension, and we are fully prepared to put our policy where our principles are. Last week, the President announced that he would send legislation to Congress creating enterprise zones that will promote economic growth in depressed areas.

It is a strategy that we believe will revitalize many of the depressed areas in this country -- particularly in the inner cities.

We believe that reducing the burdens of taxation and Federal regulation will create a hospitable economic atmosphere in these zones -- one that encourages new businesses and preserves existing businesses.

The course we have charted requires discipline and courage on the part of all of us. But, believe me, it is

the only course which will lead to sustained lowering of interest rates -- and recovery.

Sound public policy can come from the Government. But real economic growth can only come from the private sector. And that leads to the responsibility of those of you in business.

Now is the time for business leaders to show strength, not timidity; statesmanship, not parochial interests.

The American economy, the most massive and complex in the world, resembles one of those million-ton oil tankers. You cannot turn it around on a dime, or slam on the brakes if it is goes too far in any one direction. Our economy is the same way. But the captain on the bridge has signalled the turn, the rudder has been moved, the engine room is operating under a new set of commands, and -- if we will just be patient -- the economy will respond.

Thank you very much.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE April 5, 1982

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 4,701 million of 13-week bills and for $4,703 million of 26-week bills, both to be issued on April 8, 1982, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 8, 1982			26-week bills maturing October 7, 1982		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	96.747	12.869%	13.49%	93.550	12.758%	13.83%
Low	96.729	12.940%	13.56%	93.514	12.829%	13.91%
Average	96.741	12.893%	13.51%	93.528	12.802% 2/	13.88%

Tenders at the low price for the 13-week bills were allotted 34%.
Tenders at the low price for the 26-week bills were allotted 42%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 64,740	$ 48,880	$ 100,325	$ 69,825
New York	10,487,770	3,550,085	10,025,765	3,279,965
Philadelphia	46,815	44,245	25,300	25,300
Cleveland	67,245	52,180	88,770	52,270
Richmond	51,555	50,955	52,740	50,740
Atlanta	66,270	60,670	59,175	56,775
Chicago	987,130	134,770	1,005,490	278,790
St. Louis	36,770	36,110	32,785	30,785
Minneapolis	22,955	9,955	25,280	17,280
Kansas City	55,195	54,825	47,190	46,430
Dallas	46,640	46,640	23,060	23,060
San Francisco	925,885	280,365	1,224,010	502,010
Treasury	331,170	331,170	269,965	269,965
TOTALS	$13,190,140	$4,700,850	$12,979,855	$4,703,195
Type				
Competitive	$11,066,130	$2,576,840	$10,994,455	$2,717,795
Noncompetitive	1,225,950	1,225,950	981,600	981,600
Subtotal, Public	$12,292,080	$3,802,790	$11,976,055	$3,699,395
Federal Reserve	752,960	752,960	745,000	745,000
Foreign Official Institutions	145,100	145,100	258,800	258,800
TOTALS	$13,190,140	$4,700,850	$12,979,855	$4,703,195

1/ Equivalent coupon-issue yield.
2/ The four-week average for calculating the maximum interest rate payable on money market certificates is 12.920%.

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DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

(12 CFR Part 1204)

[DOCKET NO. D-0023]

91-Day Time Deposits of Less Than $100,000

AGENCY: Depository Institutions Deregulation Committee.

ACTION: Final rule.

SUMMARY: The Depository Institutions Deregulation Committee ("Committee") has established a new category of time deposit that will enable depository institutions to compete more effectively with short-term market instruments. The new deposit category has the following principal characteristics: (1) a minimum denomination of $7,500; (2) a maturity of exactly 91 days; (3) a fixed ceiling rate of interest based on the most recent rate established and announced for U.S. Treasury bills with maturities of 91 days (auction average on a discount basis); and (4) compounding of interest is not permitted. The Committee also established a temporary 25 basis point differential in favor of thrift institutions for one year and a separate minimum early withdrawal penalty for this deposit category. The temporary differential will also not apply when the Treasury bill rate is 9 per cent or less for four consecutive auctions.

EFFECTIVE DATE: May 1, 1982.

FOR FURTHER INFORMATION CONTACT: Rebecca Laird, Senior Associate General Counsel, Federal Home Loan Bank Board (202/377-6446), Mark Leemon, Attorney, Office of the Comptroller of the Currency (202/447-1880), F. Douglas Birdzell, Counsel, or Joseph A. DiNuzzo, Attorney, Federal Deposit Insurance Corporation (202/389-4147), Daniel L. Rhoads, Attorney, Board of Governors of the Federal Reserve System (202/452-3711), or Elaine Boutilier, Attorney-Advisor, Department of the Treasury (202/566-8737).

SUPPLEMENTARY INFORMATION: The Depository Institutions Deregulation Act of 1980 (Title II of P.L. 96-221; 12 U.S.C. §§ 3501 et seq.) ("Act") was enacted to provide for the orderly phaseout and ultimate elimination of the limitations on the maximum rates of interest and dividends that may be paid on deposit accounts by depository institutions as rapidly as economic conditions warrant and with due regard for the safety and soundness of depository institutions. Under the Act, the Committee is authorized to phase out interest rate ceilings by any one of a number of methods, including the creation of new account categories either not subject to interest rate limitations or with interest rate ceilings set at market rates of interest.

At its June 25, 1981 meeting, the Committee considered the issue of short-term time deposit instruments and decided to request public comment on the desirability of authorizing a new deposit instrument having characteristics similar to money market mutual funds (MMFs). 46 Fed. Reg. 36712 (July 15, 1981). The Committee did not put forth a specific proposal at that time. Over 400 comments were received by the Committee on this issue. (An analysis of the comments is contained in the DIDC staff paper "Proposals to Change the Method of Calculating the Ceiling Rate of MMCs and Consideration of Creation of a New Short-Term Deposit Instrument", September 16, 1981, which is available upon request from the Executive Secretary of the Committee.) Approximately half of the respondents favored creation of a new short-term instrument and about half were opposed. Those opposing the authorization of a new short-term instrument, generally thrift institutions, argued that the higher costs associated with a new deposit instrument and the potential shifts from savings accounts would add to their current earnings problems.

At its September 22, 1981 meeting, the Committee decided to solicit additional public comment (46 Fed. Reg. 50804, October 15, 1981) on several specific deposit proposals as well as the general features of short-term instruments. The three specific proposals were: (1) a ceilingless, $5,000 minimum denomination account with a transactions feature; (2) a time deposit with an initial maturity of 91 days, and a 14-day notice period thereafter, with a ceiling rate tied to the 13-week Treasury bill rate; and (3) a ceilingless $25,000 minimum denomination 1-day notice account. Comment was requested on several specific account characteristics as well.

The Committee received 844 responses on the three proposals published for comment and considered these comments at its March 22, 1982, meeting. The comments are summarized in the memorandum to the Committee dated December 10, 1981, entitled "Short-Term Investment Proposals." About 58 per cent of all respondents commenting favored a more competitive short-term instrument. The proposal was favored by a majority of commercial banks and was opposed by a majority of the thrift institutions commenting. Many of the respondents, including thrift institutions opposed to any new short-term instrument, stated that competition for short-term funds is no longer limited to competition among depository institutions but now also includes competition with MMFs. Some respondents argued that regulation of MMFs would be preferable to authorizing a new short-term instrument.

While the respondents opposing a new short-term instrument generally declined to comment on the specific proposals, those respondents who did comment preferred a ceilingless, $5,000 minimum denomination deposit with a transaction feature. This proposal was perceived as being the most effective of those proposed for meeting MMF competition. Those opposing the proposal argued that it would cause an increase in the cost of funds, primarily in shifts from passbook and NOW accounts into the new instrument. Commercial banks opposed the establishment of a differential in favor of thrift institutions while thrift institutions were in favor of such a differential.

The second proposal, the $10,000 minimum denomination time deposit with a minimum initial maturity of 91 days and a 14-day notice period thereafter, was the least popular among those favoring a new instrument. About 50 comments favored the adoption of this proposal. The comments were divided on the 14-day notice feature, and proponents were generally satisfied with its other characteristics. Opponents criticized its similarity to 26-week money market certificates and its likely inability to attract new funds, particularly funds held by MMFs.

The third proposal, a ceilingless $25,000 minimum denomination account with a 1-day notice requirement and no transaction feature, was the second-most popular of the three proposals. Proponents stated that the category would allow them to compete for deposits of corporations and individuals, while opponents felt that it would only benefit larger, highly liquid institutions.

One of the more popular of several alternative short-term instruments suggested in response to the Committee's proposal was a 91-day or 30-day instrument with a minimum denomination of $5,000, no transactions feature, and a rate tied to a comparable Treasury bill yield. About 100 respondents favored this suggested category.

At its December 16, 1981, meeting, the Committee postponed consideration of its proposals until its March 22, 1982 meeting. Since the December 16, 1981 meeting, the Committee has received over 2,500 letters (over 90 per cent of which were from commercial banks) urging active pursuit of deregulation.

The impetus behind the Committee's consideration of a short-term instrument has been the continued strong growth of MMFs while growth of small time and savings deposits at commercial banks and at thrift institutions has been weak. MMFs, though uninsured, offer an investment which includes the characteristics of a market return, liquidity, a transaction feature, no early withdrawal penalty, and can be obtained in denominations as low as $1,000. Short-term Treasury and U.S. agency securities also provide competition to depository institutions in that they offer a market return, tax advantages, liquidity, safety, and can be obtained in minimum denominations of $5,000 to $10,000.

In order to assist depository institutions in competing with non-depository institutions that offer alternative short-term instruments, the Committee has determined to authorize a new deposit instrument that will enable depository institutions to attract new funds, will help stem deposit outflows and will enhance the ability of institutions to retain valuable customer relationships.

After consideration of the comments received, the Committee has determined to authorize, effective May 1, 1982, a new category of short-term time deposit as follows:

--minimum denomination of $7,500

--91-day maturity

--a fixed ceiling rate for savings and loan associations and mutual savings banks equal to the 91-day Treasury bill rate (auction average on a discount basis) at the most recent auction. The ceiling rate for commercial banks will be 25 basis points less than the thrift ceiling rate. The rate will become effective the day following the auction.

--no compounding of interest is permitted

--may be offered in either negotiable or nonnegotiable form

--the 25 basis points differential in favor of thrift institutions is authorized until May 1, 1983. In addition, the differential will not apply whenever the 13-week Treasury bill rate is at or below 9 per cent for the four most recent consecutive auctions. When the differential is not in effect, commercial banks may pay the thrift ceiling rate.

--a separate minimum early withdrawal penalty of forfeiture only of all interest earned, and

--the account is available to all depositors.

United States Treasury bills maturing in 91 days are auctioned weekly by the Treasury Department, normally on Monday. The 91-day United States Treasury bill rate will be announced by Treasury and is published widely in many newspapers throughout the country. The ceiling rate payable for new deposits, as determined by the most recent auction, will be effective on the day following the auction.

The rate payable on these deposits may not exceed the ceiling rate in effect on the date of deposit. If such deposits are renewed, automatically or otherwise, the maximum rate that may be paid may not exceed the 91-day Treasury bill rate in effect at the time of renewal of the deposits. Unlike the money market certificate, averaging of the four most recent auction rates will not be permitted. Premiums, however, will be permitted in accordance with the Committee's rules.

The temporary 25 basis point ceiling rate differential in favor of thrift institutions will expire on May 1, 1983. In addition, the temporary differential will not apply if the 91-day Treasury bill discount rate (auction average) is at or below 9 per cent for the four most recent auctions of 91-day Treasury bills held immediately prior to the date of deposit. When the differential is not in effect, commercial banks will be permitted to pay the ceiling rate authorized for thrift institutions.

The Committee recognizes that the new deposit category will not be fully competitive with instruments offered by non-depository institutions. Therefore, the Committee has also directed its staff to consider additional short-term deposit categories to enable depository institutions to compete more effectively with non-depository institutions. The staff was requested to present its recommendations to the Committee within 30 days.

The Committee considered the potential effect on small entities of this new category when it established the instrument, as required by the Regulatory Flexibility Act (5 U.S.C. § 603 et seq.). In this regard, the Committee's action would not impose any new reporting or recordkeeping requirements. Small entities which are depositors generally should benefit from the Committee's proposal, since the new instrument would provide them a market rate of return. If low-yielding deposits shift into the new account, small entities which are depository institutions might have increased costs as a result of this action. However, their competitive position vis-a-vis nondepository competitors should be enhanced by their ability to offer a competitive short-term instrument at market rates. The new funds attracted by the new instrument (or the retention of deposits that might otherwise have left the institution) could be invested at a positive spread and would therefore at least partially offset the higher costs associated with the shifting of low-yielding accounts.

Pursuant to its authority under Title II of Public Law 96-221, 94 Stat. 142 (12 U.S.C. § 3501 et seq.), to prescribe rules governing the payment of interest and dividends on deposits of federally insured commercial banks, savings and loan associations, and mutual savings banks, effective May 1, 1982, the Committee amends Part 1204 (Interest on Deposits) by adding section 120 as follows:

§ 1204.120 - 91-Day Time Deposits of Less than $100,000.

(a) Commercial banks, mutual savings banks, and savings and loan associations may pay interest on any negotiable or nonnegotiable time deposit of $7,500 or more, with a maturity of 91 days, at a rate not to exceed the ceiling rates set forth below. Rounding any rate upward is not permitted, and interest may not be compounded during the term of this deposit.

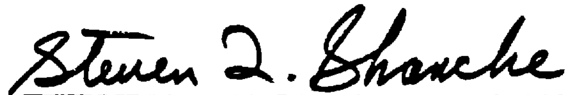
(b)(1) The ceiling rate of interest payable by mutual savings banks and savings and loan associations shall be the rate established and announced (auction average on a discount basis) for U.S. Treasury bills with maturities of 91 days at the auction held immediately prior to the date of deposit ("Bill Rate"). Except as provided in subparagraphs (2) and (3) below, the ceiling rate of interest payable by commercial banks shall be the Bill Rate minus one-quarter of one percentage point (25 basis points).

(2) If the Bill Rate is 9 per cent or below at the four most recent auctions of U.S. Treasury bills with maturities of 91 days held immediately prior to the date of deposit, the ceiling rate of interest payable by commercial banks shall be the Bill Rate.

(3) Effective May 1, 1983, the ceiling rate of interest payable by commercial banks on this category of deposit for deposits issued or renewed on or after that date shall be the Bill Rate.

(c) Section 103 of this Part shall not apply to time deposits issued under this section. Where all or any part of a time deposit issued under this section is paid before maturity, a depositor shall forfeit an amount equal to at least all interest earned on the amount withdrawn.

By order of the Committee, April 1, 1982.



Steven L. Skancke
Executive Secretary

DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE

(12 CFR Part 1204)

[DOCKET NO. D-0022]

Time Deposits of Less Than $100,000 with Original Maturities of 3-1/2 Years or More

AGENCY: Depository Institutions Deregulation Committee

ACTION: Final Rule

SUMMARY: The Depository Institutions Deregulation Committee ("Committee") has established a new deposit category with a minimum original maturity of 3-1/2 years and no interest rate ceiling. Under a schedule established by the Committee, the maturity of the new instrument will be reduced annually by one year until March 31, 1986, at which time it will have the minimum maturity for time deposits (currently 14 days). The schedule will also reduce the minimum and maximum maturities of the small saver certificate (SSC), but other existing categories of time deposits will not be changed by the plan.

EFFECTIVE DATE: May 1, 1982.

FOR FURTHER INFORMATION CONTACT: F. Douglas Birdzell, Counsel, or Joseph DiNuzzo, Attorney, Federal Deposit Insurance Corporation (202) 389-4147; Paul S. Pilecki, Senior Attorney, Board of Governors of the Federal Reserve System (202)452-3281; Elaine Boutilier, Attorney-Advisor, Department of the Treasury (202) 566-8737; Rebecca Laird, Senior Associate General Counsel, Federal Home Loan Bank Board (202) 377-6446; or Mark Leemon, Attorney, Office of the Comptroller of the Currency (202) 447-1880.

SUPPLEMENTARY INFORMATION: On October 6, 1981, the Committee requested public comments on two related proposals to help accomplish the Committee's statutorily-required objective of an orderly phaseout of deposit interest rate ceilings giving due regard to the safety and soundness of depository institutions (see 46 Federal Register 49137). The Committee requested comment on whether to establish a new time deposit account category that would have the following principal characteristics: (1) an initial minimum original maturity of 3-1/2 years or more; (2) no interest rate limitation; (3) a minimum denomination of $250; (4) an early withdrawal penalty equal to 9 months' simple interest; and optional features that would allow additions to the account during the first year without increasing the maturity and would permit the instrument to be negotiable. The proposal also would have established two new deposit categories in 1984 and 1985. The Committee also requested comments on a schedule that would reduce each year the minimum maturity of this new deposit category by one year.

In response to its request, the Committee received 580 letters from the public on the new deregulation plan and the proposed new account. Of the 121 savings and loan associations and 27 mutual savings banks responding, about 79 percent indicated they did not want a deregulation schedule that included a ceilingless deposit instrument. Accordingly, most of them did not respond to the specific questions regarding the characteristics of the proposed new instrument.

Of the 375 commercial banks that responded, over 80 percent favored a scheduled phaseout but disagreed over the characteristics of the proposed new instrument. The 9 regulatory agencies and Federal Reserve Banks and most of the 28 commercial bank trade associations wrote in support of the proposed plan while the 10 thrift trade associations expressed opposition. Ten individuals and non-depository institutions offered comments and half of them were opposed to the plan.

Those opposed to the proposals questioned the authority of the Committee to introduce a deregulation schedule at this time that authorizes new ceilingless instruments. They argued that such action is contrary to the Congressional mandate that the Committee phase out interest rate ceilings only if economic conditions warrant and only after due regard for the safety and soundness of depository institutions.

Those favoring the proposals expressed the view that a schedule will provide institutions with an opportunity to plan for the legislated goal of ceilingless deposit accounts. By beginning with long-term accounts, they argued it will permit financial institutions to better control their asset-liability risk and to attract longer-term deposits that are most appropriate for longer-term lending.

After considering all of the comments, the Committee has established a new deposit category to become effective on May 1, 1982. The new category will have the following characteristics: (1) no interest rate ceiling, (2) a minimum original maturity of 3-1/2 years, (3) no minimum denomination but the account must be made available in a $500 denomination, (4) permits additions to an account during the first year without extending its maturity (optional), and (5) permits the instrument to be negotiable (optional). 1/ The existing penalty for early withdrawal will apply to the new instrument. The

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1/ The Federal Home Loan Bank Board adopted on March 24, 1982 a regulation permitting institutions insured by the Federal Savings and Loan Insurance Corporation to offer certificates of deposit in negotiable form. Prior to this action which will take effect April 25, 1982 savings and loan associations were not generally permitted to offer negotiable certificates except for large denomination ($100,000) certificates.

maturity of the new instrument will be reduced annually by one year, and the new deposit category will be used in conjunction with a schedule designed to phaseout interest rate ceilings on time deposits. In addition, the minimum maturity of the SSC will be adjusted downward by the schedule to complement the new deposit category. The schedule adopted by the Committee is as follows:

Step 1 (May 1, 1982)

1. The new 3-1/2 year or longer, ceilingless deposit category becomes effective.
2. The maturity for SSCs is adjusted to 2-1/2 years to less than 3-1/2 years.

Step 2 (April 1, 1983)

1. The minimum maturity on the ceilingless deposit category is reduced to 2-1/2 years.

2. The maturity on the SSC is reduced to 1-1/2 years to less than 2-1/2 years, and the rate is tied to the average yield for 1-1/2 year Treasury securities with the 25 basis point differential retained.

Step 3 (April 1, 1984)

1. The minimum maturity for the ceilingless deposit category is reduced to 1-1/2 years.

Step 4 (April 1, 1985)

1. The minimum maturity for the ceilingless deposit category is reduced to 6 months.

Step 5 (March 31, 1986)

1. The minimum maturity for the ceilingless deposit category is reduced to the minimum maturity for time deposits in effect on that date.

The new rules apply only to new time deposits issued on or after each of the relevant dates; the rates payable on existing time and savings deposits are unaffected by the new rules. Moreover, ceiling rates for new time deposits with maturities other than those specified in the phaseout schedule on each of the relevant implementation dates will remain unchanged unless specifically acted upon in the future by the Committee.

In taking this action, the Committee concluded that the plan is necessary to provide additional returns to savers and to provide

depository institutions and their customers with a specific schedule so that institutions may better plan their asset and liability strategies in anticipation of an environment without deposit interest rate ceilings. Nonetheless, the Committee will monitor the schedule at least annually, taking into account economic conditions and with due regard for the safety and soundness of depository institutions.

The Committee asked for public comment on two other new account categories that would be established as part of the deregulation schedule. These accounts, like the SSC, would be indexed to Treasury securities but would have no thrift differential and would have a reduced minimum and maximum maturity. 2/ However, since these new accounts would not become effective until April 1984 and April 1985, the Committee determined that it should consider the necessity of such accounts at that time instead of authorizing them now. This is in keeping with the public comments, which indicated that most depository institutions would prefer fewer rather than more new accounts.

In its proposed rulemaking, the Committee requested comments on a number of features, including a minimum denomination of $250, a 9-month early withdrawal penalty, and allowing additional deposits during the first year of an account without extending its maturity. The public comments on a minimum denomination of $250 were mixed. Some respondents commented that no minimum denomination should be required, thereby allowing the institution to set whatever it believed was appropriate. However, most respondents indicated that $250 was acceptable. The Committee concluded that the institutions should be allowed the maximum flexibility possible to set a minimum denomination on the new category of time deposit without disadvantaging the small saver, and, therefore, adopted the provision currently used with the All Savers Certificate: no minimum denomination is mandated, but the account must be made available in $500 denominations. This leaves the institutions free to accept deposits of any amount, as long as a $500 account is also available.

In commenting on the feature of additional deposits during the first year, most respondents indicated that it would be feasible only if an institution offered it in conjunction with a floating rate instrument. Many opposed this feature as too complicated and confusing to the depositor. The Committee has authorized additional deposits during the first year as an optional feature of the new

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2/ The account proposed to be established in 1984 would have a maturity of 6 months to 1-1/2 years and could be offered at a rate not to exceed the 26-week U.S. Treasury rate (auction average on a discount basis). The account proposed to be established in 1985 would have a maturity of 14-days to six months and could be offered at a rate not to exceed the 13 week U.S. Treasury bill rate (auction average on a discount basis).

deposit category. Under this feature (which an institution is not required to offer) the institution may accept additional deposits at any time during the first year of the account without extending the maturity of the account. The deposit contract shall specify the method to be used for determining the rate of interest to be paid on additions to an account during that first year.

The comments received on the proposed 9-month early withdrawal penalty primarily opposed the proposal as adding confusion and making the account less attractive to depositors. Furthermore, they noted that an early withdrawal penalty longer than 6 months can be required by an institution under the existing regulation. The Committee has determined that the existing early withdrawal penalty of a forfeiture at least 6 months' interest on the amount withdrawn will apply to the new account. It should be noted, however, that under the schedule, the minimum maturity of the new account will be less than one year effective April 1, 1985. At that time the early withdrawal penalty would be that which applies to accounts of less than one year, i.e. 3 months' interest.

The minimum early withdrawal penalty for a floating rate time deposit (for which the interest rate varies during the term of the deposit) with a maturity of more than one year is an amount equal to six months' simple interest. If a depository institution ties the interest rate on its new account to an index that is beyond its control (e.g., Treasury security rate, commercial paper rate, Federal funds rate, Federal Reserve discount rate) for the entire term of the deposit, the institution may base the simple interest rate, for purposes of calculating the minimum early withdrawal penalty, on the rate in effect on the date the account is opened, or on the date of withdrawal, or on an average of the rates in effect during the term of the deposit. The institution must specify, however, whether it will use the initial interest rate, the rate on the date of withdrawal, or the average rate. For example, if the rate on the account is set at the twenty-six week Treasury bill discount rate plus 100 basis points and it changes weekly with the most recent auction results, the early withdrawal penalty rate could be the discount rate (plus 100 basis points) in effect on the date the account was opened, or the date of the withdrawal, or an average of all the rates in effect during the term of the deposit; but the method to be used must be specified in the deposit agreement.

If the depository institution chooses not to tie the interest rate on its new account to an index, but instead chooses to set the precise way in which the rate varies over the term of the deposit, or if it changes the relationship of the rate to the index (e.g., the commercial paper rate minus 50 basis points for the first six months of the instrument and the commercial paper rate at minus 100 basis points thereafter), then the early withdrawal penalty must be computed using an average of the simple interest rates on the deposit during the time period that the deposit was outstanding. If the interest rate is established at regular intervals and remains in effect for regular periods (e.g., the rate is established once

a month and remains in effect for one month), the average simple interest rate would be the sum of the rates established at each interval while the funds were on deposit, divided by the number of periods the funds were on deposit. Each partial period will be considered a full period for the purpose of this calculation. For example, if a 2-1/2 year time deposit with an interest rate that varies monthly was established on May 15, 1983, and withdrawn on July 7, 1983, the average simple interest rate would be the sum of the May, June, and July rates, divided by three.

If the length of the periods for which rates are effective varies, the average simple interest rate would be calculated by dividing the amount of time a deposit was outstanding into equal periods and then adding the rates that were in effect during those periods and dividing by the number of periods. The period used should be the shortest period for which a rate was in effect. For example, a time deposit might have the following rates in effect for the following periods at the time a depositor wished to withdraw the funds:

six months...............15%
1-1/2 years..............16%
1 year...................14%

The total amount of time the deposit was outstanding was 3 years (6 months + 1-1/2 years + 1 year). This 3-year period would then be divided into 6 periods of 6 months each. Then the rates in effect for each period would be:

1st six month period...............15%
2nd six month period...............16%
3rd six month period...............16%
4th six month period...............16%
5th six month period...............14%
6th six month period...............14%

To calculate the average simple interest rate, the rate in effect during each period would be added together -- 15 + 16 + 16 + 16 + 14 + 14 = 91. The resulting sum would then be divided by the number of periods -- 91 divided by 6 -- to yield an average simple interest rate of 15.17%.

In the case of lump-sum payments of cash that would be regarded as interest (see e.g., 12 C.F.R. 1204.109 and 12 C.F.R. 1204.111), such payments must be taken into account in computing the penalty rate. Any lump-sum payment must be prorated over the life of the deposit. The portion that is attributed to the time period during which the deposit was outstanding must be regarded as interest for purposes of computing the penalty rate. The portion attributable to the remaining life of the deposit is regarded as unearned interest and must be deducted from the principal amount of the deposit and returned to the institution.

For example, assume that cash of $100 that would be regarded as interest were given to a depositor at the opening of a $1,000, 4-year variable rate time deposit, that the entire amount is withdrawn after one year, and that the average of the rates paid on the deposit during the time it was outstanding was 12 percent. The lump-sum of $100 would be regarded by the Committee as a payment of interest and must be taken into account in computing the penalty rate. Because the deposit was outstanding for one-fourth of its expected life, a corresponding amount of the lump-sum must be taken into account in computing the penalty rate. Thus, 2.5 percent (25 divided by 1,000) must be added to the average of the rates paid during the time the deposit was outstanding (12 percent) to achieve a penalty rate of 14.5 percent. The remaining three-fourths of the lump-sum payment ($75) would be regarded as unearned interest and would be returned to the institution. Thus, the amount that the customer would return would be $147.50.

The new rule provides greater flexibility in designing accounts. Depository institutions will be permitted to accept additions in the first year to a new account governed by whatever interest rate structure -- fixed or floating -- they would choose, provided that the method of varying the interest rate is adequately disclosed in the deposit contract.

The Committee also considered the proposal to phaseout interest rate ceilings in terms of its impact on small entities, as required by the Regulatory Flexibility Act (5 U.S.C. §§ 601, et seq.). In this regard, the Committee's action does not impose any new regulatory burden, or increase any existing or add any new reporting or record keeping requirements. Instead, this action eliminates regulatory restrictions on the maximum interest rate payable for certain time deposits on May 1, 1982. Small entities that are depositors generally should benefit from the Committee's action because they will be able to earn higher rates of interest on their time deposits. Small entities that are depository institutions could have increased operating expenses as a result of this action, because it is likely that they will be paying higher interest rates on certain time deposits; on the other hand, their competitive position vis-a-vis nondepository institution competitors should be enhanced by their ability to offer higher rates on time deposits, thereby attracting new funds that can be reinvested profitably.

By law, the Committee is required to work towards the ultimate elimination of interest rate ceilings on time deposits. The Committee considered several alternatives to accomplish this objective; an analysis of these alternatives is available from the Executive Secretary of the Committee. In the Committee's view, the plan that was adopted provides the greatest flexibility for all depository institutions during the phaseout period, without having a disproportionately adverse impact on any particular size of depository institution.

Pursuant to its authority under Title II of the Depository Institutions Deregulation and Monetary Control Act of 1980, 94 Stat.

142 (12 U.S.C. § 3501 et seq.), to prescribe rules governing the payment of interest and dividends on deposits of Federally insured commercial banks, savings and loan associations, and mutual savings banks, the Committee amends Part 1204 -- Interest on Deposits (12 CFR Part 1204) as follows:

1. Effective May 1, 1982, Section 106 is amended by adding a new paragraph (c) to read as follows:

§ 1204.106 -- Time Deposits of Less Than $100,000 With Maturities of 2-1/2 Years to 4 Years.

* * *

(c)(1) Effective May 1, 1982, this section is amended by striking the term "2-1/2 years to less than 4 years" wherever it appears and inserting in its place "2-1/2 years to less than 3-1/2 years".

(2) Effective April 1, 1983, this section is amended by striking the term "2-1/2 years to less than 3-1/2 years" wherever it appears and inserting in its place "1-1/2 years to less than 2-1/2 years", and by striking the term "average 2-1/2 year yield" wherever it appears and inserting in its place "average 1-1/2 year yield".

2. Effective May 1, 1982, a new section 119 is added that would read as follows:

§ 1204.119 -- Time Deposits of Less Than $100,000 with Original Maturities of 3-1/2 Years or More.

(a) A commercial bank, mutual savings bank, or savings and loan association may pay interest at any rate as agreed to by the depositor on any time deposit with an original maturity of 3-1/2 years or more that has no minimum denomination but is made available in a denomination of $500.

(b) Any time deposit with an original maturity of 1-1/2 years or more issued pursuant to this section may provide by contract that additional deposits may be made to the account for a period of one year from the date that it is established without extending the original maturity date of the account. Deposits made to the account more than one year after the date that it is established shall extend the maturity of the entire account for a period of time at least equal to the original term of the account.

(c) Any time deposit offered pursuant to this section may be issued in a negotiable or nonnegotiable form.

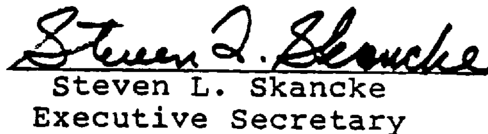
(d) Effective April 1, 1983, this section is amended by striking the term "3-1/2 years" wherever it appears and inserting in its place the term "2-1/2 years".

(e) Effective April 1, 1984, this section is amended by striking the term "2-1/2 years" wherever it appears and inserting in its place "1-1/2 years".

(f) Effective April 1, 1985, this section is amended by striking the term "1-1/2 years" wherever it appears in paragraph (a) and inserting in its place "6 months".

(g) Effective March 31, 1986, this section is amended by striking the term "with an original maturity of 6 months or more" wherever it appears.

By order of the Committee, March 26, 1982.



Steven L. Skancke
Executive Secretary

// TREASURY NEWS

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

FOR IMMEDIATE RELEASE April 6, 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 $ 9,400 million, to be issued April 15, 1982. This offering will result in a paydown for the Treasury of about $100 million, as the maturing bills are outstanding in the amount of $ 9,509 million, including $ 754 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $ 1,942 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 $4,700 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 $8,982 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 4,700 million, to be dated April 15, 1982, and to mature October 14, 1982 (CUSIP No. 912794 BP 8).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing April 15, 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, April 12, 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 three decimals, e.g., 97.920. 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 April 15, 1982, in cash or other immediately-available funds or in Treasury bills maturing April 15, 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

REMARKS BY THE HONORABLE BERYL W. SPRINKEL
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
BEFORE THE
NINTH INTERNATIONAL TRADE CONFERENCE
HOUSTON, TEXAS
April 6, 1982

International Economic Policies of the Reagan Administration

I am happy to have this opportunity to address the International Trade Conference. I enjoy opportunities like this to spend some time back in the company of the business people. It gives me a chance to catch my breath after the battles in Washington. You know, I went to Washington hoping to change things, and I never expected to avoid criticism and controversy. At least I haven't been disappointed on the latter score!

The topic of my presentation today is the international economic policies of the Reagan Administration. I can almost hear your chins drop at the thought of a luncheon speech on so broad a topic. I promise to try to make it easier on you by keeping my remarks as brief as possible, bearing in mind the old rule: a good speech should be short enough that when the speaker reaches the end you can still remember the beginning.

The theme of this conference is stated as a question, "Has America's New Economic Policy Taken Hold?" I am here to answer that question from the Administration's perspective. Our policies represent a sweeping approach to international economic issues which entail some notable departures from U.S. policies of the recent past, and the current policies of many of our allies. Such a fundamental change cannot occur overnight. We are working to convince others of our point of view. And we are confident that momentum will continue to swing in our direction.

Overall Economic Philosophy

This having been said, just what are these new international economic policies of ours? We have a consistent approach to international economic issues, which is identical to our domestic economic philosophy: we believe in the free market. We believe that economic decision-making through private market activity produces more efficient results than decisions imposed by governments. And we apply this approach across the full spectrum of

our international economic policies -- to such diverse areas as economic consultation and cooperation with our Allies, our approach to foreign exchange markets, international trade and investment, and our response to the challenges of global economic development.

The title of this conference refers to our policies as "new" ones. But what makes the free-market approach so appealing to us, and so difficult for its critics to refute, is precisely that it is not new, but tested and proven to work. There is ample historical experience which demonstrates that private markets generally produce the most efficient economic outcomes. Government planning and intervention, on the other hand, is an inefficient and costly means of organizing economic activity: it is too inflexible to react to the constantly changing economic environment, and too limited in resources to duplicate the intricate and automatic allocation and coordination mechanisms built into the market system.

A vivid historical testimonial to the effectiveness of a free-market approach to international economic issues is the Western economic recovery from World War II, and the decades of rapid economic growth which followed. Domestically, the Western industrial nations were rebuilt with a general free-market orientation. Internationally, the major factor underlying the ensuing growth performance was a dramatic expansion in world trade and capital flows. This expansion would not have taken place without the progressive liberalization of international trade and capital markets, in which the United States played a leading role. Restoration of convertible currencies, gradual removal of exchange and capital controls, and the reduction of tariffs and quotas all gave impetus to vigorous postwar economic growth -- both in industrial countries and developing ones.

During the first two postwar decades, the United States was not just a leader in liberalizing the international trading system -- our strong currency and our comparatively good domestic economic performance made United States a reliable center for the international economy. However, in the past decade or so the United States has often been a source of instability -- most particularly due to its deteriorating growth and inflation performance. Some of this deterioration in U.S. performance reflected a response to the oil shocks, which we experienced in common with every other oil-importing nation. But a significant cause of our disappointing record has been domestic economic policy. Sometimes the U.S. took interventionist approaches to domestic problems which the market mechanism could have addressed more appropriately. And attempts at fine-tuning with a short-term policy horizon ended up giving other goals so much precedence over economic efficiency that the ultimate results were a substantial worsening in U.S. productivity peformance, and an inflationary bias in wage and price formation.

As you know, our domestic economic program is intended to reverse this process. And putting our domestic house in order will bring substantial benefits for the rest of the world, from a

strong and stable dollar, a lessening of protectionist pressures, and a healthy and growing U.S. economy as a market for foreign goods and a reliable financial intermediary.

Interest Rates and Exchange Rates

Our transition from a period of inflationary and destabilizing economic policy to a non-inflationary growth path has unfortunately turned out to be a difficult one -- difficult to go through, and difficult to implement. Domestically the implementation problem has been manifested most clearly in high interest rates. And interest rates have drawn plenty of attention abroad as well.

I am sure that you are familar with the basic foreign criticisms of U.S. economic policy. They believe we should not persist in a tight monetary policy in the face of an already weak economy, a large government budget deficit, and historically high interest rates. They feel that our interest rates contribute to rising unemployment in Europe. And at the same time, they suggest that because high U.S. interest rates and volatile U.S. monetary policy are causing exchange market instability and adding to the uncertainties of an already difficult environment, we should be willing to intervene in exchange markets to dampen exchange rate movements. Our distaste for intervention in exchange markets is sometimes described as prima facie evidence of our insensitivity to European interests and our unwillingness to cooperate with other countries.

In our direct discussions with foreign governments, we believe we have answered these criticisms successfully -- although not always to their satisfaction. We honestly believe that the best way of getting back on a vigorous, non-inflationary growth path will be to persevere in our efforts to get inflation under control, to reduce the size and intrusiveness of government, and to revitalize the private sector of the economy. And I think foreign leaders and economic officials understand the logic of our approach. Most of them are also attempting to implement sounder economic policies in order to control inflation and restore the dynamism of their economies. But for now, the difficult political problems of the transition period are more painfully clear than the benefits we stand to gain.

The standard foreign argument has been that our interest rates are higher than necessary, due to a mistaken "policy mix" of loose fiscal and tight monetary policy -- and that these high U.S. interest rates weaken their currencies. Many feel they have been forced to drive their own interest rates to artificially high levels, in order to avoid an even more dramatic currency depreciation. Their basic prescription has been that we should move faster to balance the budget (through higher taxes if necessary), perhaps ease monetary policy, and join them in coordinated exchange market intervention.

While there is some impact, we believe the impact of our interest rates on Europe has been exaggerated. High foreign interest rates and weak foreign currencies have not been just

passive reactions to U.S. monetary policy and interest rates. On some occasions, increases in foreign interest rates can have something to do with U.S. rates, but generally they have even more to do with events abroad like past inflation performance, persistent inflation expectations, and the large budget deficits and external financing needs faced by some countries.

The weakness of some foreign currencies has also reflected many other factors besides high U.S. interest rates. Negative factors for Europe have included inflation trends during the last year, uncertainty over the resolve of European governments to continue the fight against inflation, generally weak European current account positions, and political developments such as the Polish situation. A partial analysis which looks only at the simple correlation between two variables and assigns a causal relationship is usually misleading. But, in fact, there was usually very little correlation between changes in international interest rate differentials and exchange rate movements last year. This winter, the rebound in U.S. interest rates did seem to have some direct exchange market impacts, but that correlation is already weakening again. As U.S. interest rates decline again differentials may move against us, but the dollar might well remain strong for other reasons.

More generally, we believe it would be counterproductive to change our policy mix in the manner suggested. Large budget deficits are putting some upward pressure on interest rates, as government financing needs crowd out private credit demand. But the order of magnitude of this impact simply cannot be sufficient to explain the level of interest rates we have seen recently. Furthermore, the total available pool of credit available is being expanded dramatically, both by the measures which this Administration has taken to increase savings, and by an unwinding of the widespread speculative investment in real assets which took place as a result of accelerating inflation over the last few years. These factors further dilute the crowding-out effect. Finally, inflation itself has come down dramatically since the beginning of of this Administration, so that cannot be the reason for persistently high interest rates either.

So excluding these explanations, we have to assume that what is going on is some combination of persistently high inflation expectations and a "risk premium," reflecting the basic unwillingness of investors to risk being trapped for long in fixed-interest investments until they are sure inflation is firmly under control. When market participants are uncertain, they tend to over-react to otherwise minor events like a transient upturn in money growth, and generate the self-fulfilling prophecy of higher interest rates.

The key to controlling inflation is a credible policy of slow, steady monetary growth. The task of establishing the credibility of the Federal Reserve was set back by its poor performance in controlling the money supply in the past -- and until credibility is established, financial markets will probably

continue to be skittish. The recent acceleration of money growth did little to help this, and confusing signals on fiscal policy options in recent months added to the basic uncertainty. What is needed is a clear perception that economic policy will stay on a steady, non-inflationary course. This Administration is going to stick to a steady course, and we fully support the Fed's intention to do the same.

International Economic Cooperation

Although we are sometimes accused of insensitivity to foreign concerns, the fact is we are very aware of the opinions and aspirations of our allies, and try to take every available opportunity to consult with them and arrive at common understandings. Secretary Regan and other Treasury officials -- myself included -- meet frequently, both in Washington and abroad, with our foreign counterparts to discuss key economic issues and to exchange information. I am hopeful that as we get further down the road in our own process of controlling inflation and stabilizing the economic policy environment, the other major Western industrial countries will also have been moving with us toward a consistent and coordinated approach to controlling inflation and setting the stage for strong and sustainable economic growth.

We believe in economic cooperation and consultation with our allies -- in a candid exchange of new ideas and points of view, in timely notifications of policy changes or upcoming economic events which impact on one another's policies, and in a thorough airing of grievances in hopes of finding mutually acceptable solutions. We are fully aware that the demands of international cooperation sometimes require a country to forego its immediate self-interest in pursuit of fundamental common goals. We are receptive to approaches which trade short-run losses for more significant long-run gains. But we are wary of approaches which run counter to the fundamentals, such as ones which imply collaboration to circumvent the market system and further distort global resource allocation. We are not backers of subtle international cartelization schemes, or of proposals to substitute governmental "organization" for the free international trading system.

Our foreign exchange market policy is a case in point. Our policy in that area is straightforward -- we are minimizing our intervention in foreign exchange markets, by restricting it to cases of serious disorder which disrupt the normal functioning of these markets. Our policy has been described in some European countries as one of "benign neglect." But this description is very misleading -- it implies both that as a result we are "gaining" something at the expense of our allies, and that we are "neglecting" an opportunity to influence events. Neither is true.

We have two basic reasons for our minimal intervention policy. The first is that we do not believe any government or individual is capable of second-guessing what the correct level of an exchange rate should be. The second is that, historically, intervention to fix or manage exchange rates simply hasn't worked.

Economists have plausible theories about the main factors determining exchange rates in the long run. But in the short run, a much greater variety of factors can influence exchange rates, not all of which are measurable or obvious. Exchange markets are large and efficient, and market participants make rapid use of all available information in arriving at a collective "decision" as to what rates should be. What quite often drives short-run rate movements are changing market expectations -- expectations about the future behavior of market fundamentals like inflation rates and balance of payments developments. But these expectations do not necessarily bear any relationship to what those fundamentals are doing currently, and may even turn out to be inaccurate predictions of their future behavior.

Thus, it is presumptuous for anybody, governments included, to think they have sufficient information to pinpoint an equilibrium exchange rate different from what the market has produced at any given point in time. Even if intervention were capable of moving rate levels against market forces, in doing so it would be more likely to do harm than good. At best it would be a waste of money.

So perhaps it is fortunate that intervention to fix or manage exchange rates has been so spectacularly unsuccessful. The major Western governments intervened frequently and massively during the late 1970s, but this did not prevent large and rapid exchange rate movements in the very directions they were trying to avoid.

There is only one way to attain exchange rate stability, and that is through greater similarity in the economic policies and performance of the major economies. I would welcome with open arms any attempt to get stability this way.

In fact, I expect this will be a major theme for the Economic Summit meeting in Versailles this June. We will be discussing ways that the major industrial countries can undertake a more similar set of stable and non-inflationary economic policies, based on monetary and fiscal discipline and free-market principles.

International Trade and Investment

In the area of international trade, postwar economic history hammered home the lesson that a liberal trading system is good for all participants, while any tendency toward increased protectionism threatens this major source of dynamism in the international economy. The Administration is on guard against encroachments to the free international system of trade and investment and is pushing for further liberalization. We hope that other countries -- both developed and developing -- will do their part as well, since we all share equally in the gains.

A topic of particular concern to us is international investment. Anything that distorts or impedes the free flow of international investment has unfortunate implications for global resource allocation and growth. Many countries feel they have legitimate reasons to offer incentives to attract foreign investors;

to force those investors to meet performance requirements; to control foreign investment in sensitive sectors of their economies; or to ensure that the achievement of their most basic domestic economic goals is not arbitrarily frustrated by the actions of multinational corporations. We are not always in sympathy with all of their goals, but we recognize that the autonomy of national economic policies is a basic and desirable feature of international relations.

Nevertheless, we believe there must be limits on such measures. We are very concerned with the recent proliferation of government interventions which attempt to appropriate the benefits of foreign investment -- and at the same time seriously distort trade and investment flows. Use of investment incentives and performance requirements can be tantamount to an unsubtle version of beggar-thy-neighbor trade competition. In some countries, the property rights of foreign investors have become unacceptably tenuous; and many treat foreign investors in ways that leave them at a significant competitive disadvantage vis-a-vis local firms.

While the United States has bilateral agreements covering some international investment issues, and is a participant in multilateral investment codes under the auspices of the OECD and the United Nations, we believe these agreements are woefully inadequate to address current problems. They don't cover all the relevant issues or countries, and they are not binding mechanisms for resolving disputes. The most comprehensive of the agreements, those negotiated in the OECD, bear no relation to the activities of the LDCs.

This year, we are pressing to begin negotiations on a set of binding rules to govern restrictions on international investment. We have taken up this topic in bilateral consultations with our major trading partners, and in appropriate OECD meetings. We expect that it will be a major topic of discussion at the Versailles Summit in June, and at the November GATT Ministerial.

Economic Growth and Development

I hope it will come as no surprise to this audience that neither the Reagan Administration's free-market approach, nor our actions to cut the growth of government spending, has required us to turn our backs on the needs of developing countries. We believe that all countries should have the opportunity to grow, and to participate more fully in the benefits and obligations of the international trading system.

To this end, in the latest budget, we are proposing to expand our expenditures for both bilateral and multilateral foreign economic assistance next year, in contrast with actual cutbacks in many significant domestic programs. We believe that the domestic economic policies of developing countries are the most important determinant of their growth rates, although assistance should be available to meet the most urgent needs of the desperately poor. And to these ends we are increasing our support for the original purposes and

philosophies of multilateral institutions such as the development banks and the International Monetary Fund.

We recognize that these institutions serve a number of purposes. They have been important contributors to the expansion of private economic activity which underlay the world's rapid postwar economic growth. They are supportive of fundamental U.S. economic, political, and security interests. And by promoting sound economic policies, these institutions make lasting and tangible contributions to economic and social advancement in borrowing countries. Overall, they are clearly among the most successful cooperative economic endeavors in history.

In its role as the world's central official international monetary institution, the IMF performs a number of functions. It provides a mechanism through which governments can consult and cooperate to maintain and improve the functioning of the international monetary system. It serves as a means for monitoring the appropriateness of its member's exchange arrangements and policies. The IMF is also charged with reviewing the adequacy of international liquidity and supplementing reserves when necessary by allocating Special Drawing Rights. Finally, the IMF provides technical assistance and temporary balance-of-payments financing to its members, conditional on their implementation of economic policies designed to correct their domestic and external imbalances.

This Administration views the IMF as a cornerstone of our international economic policy. We support the key roles the IMF plays in the international monetary system, and welcome the IMF's focus on market forces, economic fundamentals, and the need for sound economic policy. We are also working actively to ensure that IMF conditionality is used effectively to bring about economic adjustment, by supporting economic policies in borrowing countries which give wider scope to market forces.

We also see an important continuing role for the multilateral development banks. With some modification in their procedures, the banks can expand their role as catalysts for the mobilization of the private sector resources which are essential to growth and development. In late February, we released a thorough report on U.S. participation in the MDBs which stressed the directions in which we think their activities should be guided. Our suggestions are aimed at enhancing both the catalytic role of the MDBs and their ability to provide sound economic policy advice.

The key elements of our proposals are straightforward. We will seek to have MDB lending practices place greater stress on market forces -- on the importance of appropriate pricing structures and incentives. We are asking the banks to make greater resort to guarantees, participations, and co-financing as ways of stimulating increased private foreign investment in developing countries. Rather than continuing to meet arbitrary annual lending targets, we are suggesting that the banks take a selective approach -- gearing their lending to the willingness of borrowers to implement needed policy changes through stricter conditionality. And we

will be working to ensure that scarce concessional loan funds are reserved for the poorest of the developing countries. The MDBs should have a "maturation" policy which reduces borrowing countries' access to these "soft" loans as their economic conditions and creditworthiness improve -- eventually aiming at "graduation," when access to "soft" loans can be cut off entirely. Finally, since the banks will be working more with private lenders, we expect there will be a phasing-out of paid-in capital subscriptions as a source of MDB resources. As a result, we will be reducing in real terms the U.S. budget outlays which provide resources for direct MDB loans in future years.

We are hoping the MDBs will be able to move further in these directions in the near future. In this way, their effectiveness will grow and they will be able to play an important role over the remainder of this decade.

Conclusion

While I have tried to be brief, I fear I may have spoken longer than you expected in describing our "not-so-new" approach to international economic policies. Please don't let my elaboration of details in the many specific policy areas obscure the clarity and simplicity of our basic message. We believe in the market approach to economic decision-making, and we believe that the free-market answer is the right answer to most economic problems.

We are trying to avoid building up unrealistic expectations about what the participants in the international economic system can hope to accomplish. In a cynical mood, Toulouse-Lautrec once said, "Marriage is a long dull meal with dessert at the beginning." Unlike his idea of marriage, we have not tried to put dessert at the beginning by concocting dramatic strategies for "a quick fix" of the world's problems. Such strategies are always disappointed. But we know the policies we have chosen will be effective, as they have been in the past.

TREASURY NEWS

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April 6, 1982

Address by
Donald T. Regan
Secretary of the Treasury
to the
Harvard Business School Statesman Award Dinner
New York, New York
April 6, 1982

I am, of course, both touched and honored to receive this award, and to join a distinguished company of past recipients. But I'm a bit leery of being called a statesman. A statesman, you know, has been defined as a politician who's been dead for ten years -- or a businessman dead for twenty. But it's always nice to rejoin the company of Harvard men and women. Actually, there were those who scoffed at the idea of a Harvard English major becoming Ronald Reagan's Treasury Secretary. But in the fifteen months since this administration took office, I like to think I've proved my worth. For instance, who better than a Harvard English major to explain the significance of a Trojan Horse? And if there's little poetry in supply side economics, I've found more than enough creative fiction in trillion dollar deficits.

In truth, I've looked forward to this evening with more than nostalgia in mind. Like you, I retain a special affection for that intellectual hothouse called Harvard -- even if some of us got our education on the other side of the Charles. Nowhere else is there such a congregation of compelling ideas and inspiring ghosts. In one square mile of red brick and green ivy, Ralph Waldo Emerson ruminated and Louis Agassiz studied fossil life. Franklin Roosevelt edited the Crimson and George Marshall called for a new Europe to rise from the rubble of the old.

Harvard Business School is one of the brightest facets of the University. Their case study methods are known far and wide. I'm told that students in the Business School can now take a special course in business ethics.

I am reminded of the young boy who asked his father to define "business ethics." The man -- a merchant himself -- described the following example.

"Son, suppose someone buys something from me, gives me the exact price -- $5.00 -- and starts towards the door. And suppose that while I'm on my way to the cash register I realize that he's actually given me two $5.00 bills stuck together. That poses an ethical question for me: Should I tell my partner?"

Most graduates of Harvard - whether from the business school or any other program - are mindful of the words of a Harvard

R-719

president, Charles William Elliot, who had carved over one entrance to the Yard his personal motto ... "Enter to grow in wisdom, depart better to serve thy country and thy kind." I might add that when I first became Secretary of the Treasury, I toyed with the notion of having an inscription of my own carved into the Treasury building, something from Dante like, "Abandon hope, all ye who enter here."

Harvard enjoys a premier position in the intellectual and public lives of this country. And it isn't due simply to great teachers, or innovative labs, or world-class libraries. For without the tradition of service, personified by Elliot and continued across the span of three and a half centuries, Harvard would be little more than a provincial cloister.

Service can be defined in many ways. In my own life, I have pursued it within the capitalist framework because I believe in the power of capitalism to deliver more freedom, more opportunity, more social mobility and more abundance than any other system devised by man. I believe in rewarding the risktaker. I believe in profit as an incentive and in the widest possible distribution of justice, as well as wealth.

Franklin Roosevelt used to say that the inherent vice of capitalism was the unequal sharing of blessings -- while the inherent virtue of socialism was the equal sharing of misery. Nineteenth century intellectuals practically coined the word "capitalist" as an insult to the countinghouse society. And Harvard itself, for an institution with a 1.6 billion dollar endowment, has sometimes seemed uncomfortable with entrepreneurial zeal. In the land of J.K. Galbraith and J.M. Keynes, profit has not always been regarded as a positive thing, and capitalism has often been regarded as the handmaiden of greed.

But the kind of capitalism I have in mind demands more than creature comfort. It demands a fair distribution of profit -- and a widespread assumption of responsibility. For there can be no real prosperity in a land where millions are denied a chance at success. Profit itself has little justification unless it becomes the fuel for social progress and capitalism must have an underlying morality if it is not to degenerate into mere acquisition on a grand scale.

It is that vision of a <u>responsible</u> capitalism which this administration holds. Imagine the economic system as a kind of race. Government maintains the track and provides basic training to all the racers. It strives to insure all runners an equal shot at the start. It umpires the race to insure fairness. Butit cannot guarantee the outcome. If it were government of the elite, it could select those who would run and those who would win. If it were a Socialist government, it could compel all the runners to run slowly and to end the race evenly matched.

President Reagan sees it differently. "We all must move ahead," he told the NAACP last summer, "but we can't leave anyone behind."

The Reagan White House -- like our alma mater -- is no lonely outpost of laissez-faire. As the last half century has seen a constant narrowing of the old gulf between business and the humanities, so government has come to assume an ever-greater role in economic affairs. For fifty years, we have turned to Washington to feed the hungry, house the homeless, provide work for the unemployed. So government swelled to meet our demands, it came to confuse responsibility with dictation. It promised to realize our dreams -- but spent much of its time merely sleepwalking. It vowed to raise the floor beneath the poor -- but lowered the ceiling on everyone else. It sought to divide existing wealth more evenly -- rather than foster the creation of new wealth for millions of Americans.

Government set out with the best of intentions -- and somewhere along the way, it became little more than a costly burden. An assembly-line of do's and don'ts, seeking to be compassionate, forgetting to be competent. And nowhere did its mismanagement have more disastrous or ironic effects than in the economic realm. Compassion is a word much in today's headlines. Like all words, it is vulnerable to distortion. Real compassion does not tolerate double-digit inflation. It does not accept welfare lines in lieu of lasting jobs. It is not comfortable with a spider's web of red tape that cripples the small businessman or woman without adding materially to the protection of anything, except the bureaucratic peace of mind.

Real compassion is contained in a weekly paycheck with a reduced tax bite -- a grocery or gas bill that doesn't force a choice between eating or heating. Real compassion offers a hand up instead of a hand out. Real compassion defines the ultimate social justice as the right of individual self-support.

Real compassion and capitalism of the American brand have always been comfortable partners. For it was capitalists who cursed the darkness and replaced it with light -- who replaced cold with heat, scarcity with plenty, and squalor with comfort. Capitalists put Americans on the road -- and sent other Americans up into the heavens. Capitalists have brought better hygiene to the underdeveloped world -- more food to feed hungry mouths -- and more hope in lands where that most precious of all commodities would be otherwise extinct.

Capitalism succeeds best when allied with what my illustrious predecessor, Alexander Hamilton, called "moral obligation." It reaches its zenith in an atmosphere of democracy, equity, fairness and, yes, real compassion. It is based on the genius of individual men and women, and thrives wherever those individuals are protected and wherever their diversity is maintained. So why is capitalism a dirty word

to so many -- including, sad to say -- some who have sought for fifty years to keep words like profit and incentive out of polite conversation in our own land?

Well, for one thing, the very puritan ethic said to engender an appreciation of moneymaking also recoils at public celebration of the marketplace. So-called "bourgeois values" strike us as dull; it is hard to imagine many banners proclaiming the philisophical thrills of thrift, discipline, hard work and moderation. Yet if it isn't romantic, then capitalism is not without a heart of its own. If you doubt that, consider the fact that more than half of the adults in America -- 84 million in all -- give some of their spare time to a cause worthier than their own line of work. That's 84 million of us, rolling up our sleeves instead of twiddling our thumbs. 84 million potential solutions to America's problems.

And because we recognize the voluntary spirit in this country, the President has launched a major campaign to tap the ingenuity as well as the corporate coffers of the capitalists among us. His Private Sector Initiatives program is already unleashing the skill and enthusiasm of an aroused private sector on some of our most intractable social ills. More than any in memory, this administration is counting on the marketplace to improve the standard of living for millions. This does not mean retreat from social responsibility; rather, it means sharing that responsibility with more partners than ever before. We areletting more dollars stay in more hands. We are hacking our way through the regulatory jungle. We are on our way toward making free enterprise freer than it's been in half a century.

But that is only because we care about people as well as profits. Society holds the ultimate franchise on free enterprise -- and we intend to use that franchise. In Urban Enterprise Zones, we will invite business and industry to generate hope as well as income. Where Washington has behaved irresponsibly, we will call on capitalism to act responsibly. We will turn away from the failed dogmas of recent history, and we will insist on a creative alternative from you, who are among the most creative of Americans.

For as long as I can remember, you and I have argued that government could not, by itself, guarantee economic prosperity. It could not tax and tax, spend and spend its way to social justice. It could, with the help of a vigorous private sector, achieve both. And so it is that the Reagan Administration has departed from the rutted road of paternalistic government, to try something different. I don't have to describe our program for you, but perhaps I need to remind you of some of its accomplishments. Perhaps I need to point out that inflation for the first three months of this year is running around 3.5 percent, less than where it stood the day Jimmy Carter took office. Perhaps I should say something about interest rates that, while still too high, have come down by over 20 percent

since Ronald Reagan took office. Perhaps I should mention that the rate of growth in federal spending is being reduced dramatically -- along with the pace of government regulation. If you don't take my word for it, then take a look at last year's Federal Register; you'll find it 23,000 pages slimmer than in 1980. Finally, perhaps I ought to say something about the rate of savings in this country, which is finally turning around, and the rate of taxation, which without the President's program would have consumed more than 24 percent of the GNP by 1986.

Then, having said all that, perhaps I should point out the alternative, which is more of the same pump-priming and logrolling that have characterized our opponents for all of their political lives. Incredibly the people who caused them have now taken to criticizing the federal deficit.

Deficits are a problem. Personally, I'd be more comfortable if I could name a date when the budget would be in balance. But we were elected to restore the economic health of this country. Once the President's tax and other incentives begin to do just that, then we will see the way toward a budget with a lot less red ink in it. For now, I would simply point out that Gerald Ford's administration sustained a $66 billion deficit in 1976 -- while Jimmy Carter managed to whittle that figure down to just $27 billion by 1979. Yet in the same time, inflation doubled and interest rates soared to record levels. I'd be a lot more worried about the size of the current deficit if it weren't for the size of new savings built in to the President's program: this year alone, new savings will reach $60 billion and by 1984, new savings will have added $260 billion to retool, modernize and aggressively pursue new innovations and new markets.

We've provided the tools for quick recovery -- and for lasting prosperity. And oppose any cutback in the President's basic program of tax relief precisely because it would reduce consumer purchasing power as well as the pool of available capital, thereby delaying recovery. We have defended the program against those who would dull the tools and return to the stale solutions of an earlier time. We have even stood up against some elements of the business community itself, who have called for a rollback in personal tax cuts while preserving accelerated cost recovery and safe harbor leasing. We have done so, not only in the name of elemental fairness -- but because tampering with one element of the basic tax program puts the entire program at risk.

What the public demands of American business is very close to what the Reagan Administration expects. We don't want just more yachts in U.S. harbors, but more plants in U.S. cities. We don't expect free enterprise to take over the social welfare programs -- but we do expect it to join vigorously in our own efforts to reclaim millions of our young and hundreds of urban neighborhoods for the economic system in which we share a common faith. We expect business to sustain our behalf that it can be an engine of social progress, and not merely one more sacred cow

feeding at the Washington trough.

Earlier, I spoke of President Elliot, and of the tradition of service he bequeathed to each succeeding Harvard generation. Elliot had another admonition to give to the forty classes over which he presided. It's just as relevant today. "Look up and not down," he told his fellow Harvard men, "look out and not in; look forward and not back, and lend a hand."

If I could leave you with a message beyond the economic statistics and political arguments, that would be it. That, in a nutshell, sums up both the morality and the responsibility of capitalists as well as scholars. It is a formula for statesmanship that goes beyond any award. And it is the credo to which this administration will adhere.

After so many years in your ranks, I know that it is a credo you share. And so it is, that I ask you to join me now, in transforming that noble ideal into living reality. I ask you all to be statesmen of a capitalistic and caring society.

Thank you.

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TREASURY NEWS

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

FOR RELEASE AT 12:00 NOON April 8, 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 April 22, 1982, and to mature April 21, 1983 (CUSIP No. 912794 CB 8). This issue will provide about $1,000 million new cash for the Treasury, as the maturing 52-week bill was originally issued in the amount of $4,261 million. The additional issues of 136-day and 20-day cash management bills totaling $10,017 million issued on December 7, 1981, and April 2, 1982, and maturing April 22, 1982, will be redeemed at maturity.

The bills will be issued for cash and in exchange for Treasury bills maturing April 22, 1982. In addition to the maturing 52-week and cash management bills, there are $9,473 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 $2,266 million, and Federal Reserve Banks for their own account hold $2,346 million of the maturing bills. These amounts represent the combined holdings of such accounts for the three regular 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 $828 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, April 15, 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.

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 three decimals, e.g., 97.920. 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 April 22, 1982, in cash or other immediately-available funds or in Treasury bills maturing April 22, 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.

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