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TREASURY NEWS

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DEPARTMENT OF THE TREASURY

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STATEMENT OF
DENNIS E. ROSS
ACTING TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Subcommittee:

I am pleased to present the Treasury Department's views on S.1959, which addresses the tax treatment of issuers and holders of interests in multiple class mortgage pools; S.1978, which addresses the tax treatment of multiple class mortgage pools as well as pools of various other debt instruments; and S.1839, which would limit the tax incentives available for investments or activities conducted in zones designated as environmentally sensitive. Let me turn first to the question of multiple class mortgage pools.

Overview

The Treasury Department shares the concern of this Subcommittee over the absence of clear rules governing the tax treatment of multiple class mortgage pools. Uncertainty under current law has effectively denied access to the secondary mortgage market for some issuers. Moreover, the existing uncertainty may result in a significant mismatch of the reported income of holders of interests in multiple class mortgage pools and the corresponding deductions of issuers, as well as the conversion for holders of ordinary interest income into capital gain. Since we expect the market for multiple class mortgage pools to grow, we view seriously the potential revenue loss from continued uncertainty in this area. We thus support legislation clarifying the proper reporting of income and deductions with respect to mortgage-backed securities. We also support, subject to appropriate safeguards, legislation that would effectively exempt the issuer of mortgage-backed securities from tax with respect to the underlying mortgages.

Although we support the general direction of the legislation before this Subcommittee, we remain concerned about the growth of Federal credit, including that of the Federal agencies active in the secondary mortgage market. As we have testified previously, we are concerned about the extent to which the Federal agencies currently predominate in the secondary mortgage market, and believe it important to encourage private issuers of mortgage securities to enter that market. To this end, Treasury supports legislation along the lines of S.1959 and S.1978, modified, however, to prevent participation in multiple class mortgage pools by the Federal agencies.

Background

In recent years, mortgage originators, such as thrift institutions and mortgage banks, have increasingly sold their mortgages to portfolio investors. This secondary mortgage market is based principally on the issuance of mortgage-backed securities, which have the advantage to investors of greater liquidity and less risk of default than individual whole mortgages.

The growth in the secondary mortgage market has also seen the development of new forms of mortgage-backed securities. Traditionally, mortgage-backed securities have been issued as certificates of undivided beneficial interest in "fixed investment trusts," which are viewed for tax purposes as "grantor trusts." In this format, the certificate holders are treated as the beneficial owners of the mortgages and bear all income taxes with respect to the mortgages.

In recent years, the issuance of a single class of uniform interests in a mortgage pool has proved to be relatively inefficient, since it prevents the issuer from taking advantage of the positively sloped yield curve (i.e., the fact that long-term yields exceed those for short-term obligations) or offering investors any degree of call protection (i.e., protection against a call based on prepayment of the underlying mortgages). Because individual mortgages are typically composed of a series of equal monthly payments, the cash flow from a pool of mortgages has the same temporal pattern as a series of short- and long-term obligations. A mortgage pool may thus be used to collaterize an issue of debt obligations with differing terms by allocating the anticipated mortgage payments among the different classes of securities. Such arrangements, known as "fast-pay, slow-pay" or "multiple class" pools, permit the issuer to price interests in the mortgage pool along the yield curve and to offer the slow-pay classes some degree of call protection. In this fashion, multiple class mortgage pools permit an issuer to secure a better return from a secondary marketing.

Because of uncertainty as to whether a multiple class pool could be offered as a fixed investment trust and retain grantor

trust status for tax purposes, mortgage pool issuers initially turned to an alternate structure. The Federal Home Loan Mortgage Corporation ("Freddie Mac") offered the first multiple class pool in 1983 by issuing several classes of debt securities with payment schedules tied to the actual payments on a fixed pool of mortgages. Since the Freddie Mac offering, approximately $27 billion of these securities have been issued, primarily through thinly-capitalized, single purpose financing corporations. Typically this has involved creation of a subsidiary (commonly by an investment banking firm or residential construction company) solely for the purpose of holding the pool of mortgages, selling debt obligations secured by the mortgages, and transferring mortgage payments to investors in accordance with the terms of their securities.

The type of debt obligation issued by such corporations, known as a collateralized mortgage obligation ("CMO"), is itself a relatively inefficient vehicle for marketing a pool of mortgages. Ideally, the corporate issuer would have no residual economic or tax consequences from its holding of the underlying mortgages, which is consistent with the intention that beneficial ownership of the mortgages be transferred to secondary investors. Although this economic result might be accomplished by leaving the issuer without significant capital and issuing obligations that, in the aggregate, exactly mirrored the characteristics of the underlying mortgages, this would in turn threaten the issuer's status for tax purposes as the owner of the mortgages and the issuer of corporate debt. Thus, if the issuer had no significant equity and the CMOs were designed to match exactly the cash flow from the underlying mortgages, the CMOs could be deemed to constitute equity interests in the issuer or to represent instead direct interests in the underlying mortgages. Either characterization could leave the issuer with a tax liability on the mortgage income that would more than offset the economic advantages of the multiple class structure.

To insure that the corporate issuer will be respected as owner of the mortgages and that the CMOs will be characterized as debt for tax purposes, careful issuers have attempted to satisfy minimum capitalization requirements and to retain some residual interest in the underlying mortgages. This approach, however, introduces a degree of economic inefficiency to the transaction, since it ties up capital in the issuer and prevents the issuer from borrowing fully against the underlying mortgages. As a consequence, some issuers have taken aggressive positions, providing little if any capitalization and retaining no significant residual interest in the underlying mortgages. Since the Internal Revenue Service has not to this date publicly challenged the formal structure of a CMO transaction, the net effect at present is a secondary market in which conservative issuers either operate at a disadvantage or are effectively precluded.

Aside from the uncertainties as to the tax treatment of

issuers, the CMO structure involves certain additional costs for holders and issuers of mortgage-backed securities. Under section 593 of the Code, a savings and loan association is entitled to claim bad debt deductions based on a special method if it holds a significant percentage of its assets in residential mortgages. Since the holder of a CMO is treated for this and other purposes as holding corporate debt rather than a direct interest in the underlying mortgages, CMOs may be a relatively unattractive investment for many savings and loans that might otherwise prefer a fast- or slow-pay mortgage pool interest.

Finally, the CMO structure is unattractive to some issuers because of balance sheet considerations. A relatively modest CMO transaction may involve over $200 million in debt securities. Although these transactions involve nearly offsetting assets and liabilities at the issuer level, many potential participants in the secondary mortgage market, including some banks and savings and loan associations, cannot, either due to regulatory or credit constraints, add significant amounts of debt to their balance sheets.

The Proposed Multiple Class Trust Regulations

In an attempt to retain the advantages of the multiple class structure while avoiding the tax and business obstacles of CMOs, Dean Witter and Sears in 1984 structured two grantor trusts offering investors differing temporal interests in the payment rights on $500 million pools of residential mortgages. Dean Witter and Sears succeeded in marketing interests in the first pool, but, in April of 1984, before interests in the second pool were sold, the Internal Revenue Service proposed regulations denying trust status to arrangements having multiple classes of ownership interests.

Although the proposed multiple class trust regulations have generated substantial comment, we continue to believe they were correct, as a general rule, in denying trust status to multiple class arrangements. Historically, whether an investment trust is classified as a trust or as an association has focused on whether the investors' interests were fixed or could instead be varied under the terms of the trust agreement. A power to vary the investors' interests, even though only contingent in form, is sufficient to deny the arrangement trust status. Thus, the existing investment trust regulations limit trust classification to "fixed investment trusts" where there is no power under the trust agreement to vary the investors' interests.

At the time these regulations were first promulgated in 1945, fixed investment trusts had only one class of investment certificates. The certificates represented undivided interests in the trust property and were, in form, receipts for the securities held by the trust. Thus, where the trustee had no power to vary the investment of the trust, a fixed investment

trust was little more than a depository arrangement, formed to hold a pool of specific investment assets. Although the trust device permitted individual investors to diversify, the arrangement in substance provided a form of direct, if common ownership of the trust's assets. This use of a trust to hold investment assets and facilitate direct investment in a pool of assets by investors is consistent with the custodial purposes that have traditionally limited trust classification.

A multiple class investment trust, such as that formed by Dean Witter and Sears, departs from the traditional form of a fixed investment trust in that the beneficiaries' interests are not undivided, but diverse. The existence of varied beneficial interests indicates that the trust is not employed simply to hold investment assets, but serves the additional purpose of providing investors with economic and legal interests that could not be acquired through direct investment in the trust assets. Such use of an investment trust introduces the potential for complex allocations of trust income among investors with the possibility that the timing and character of the investor's income will differ from that of the trust's.

The difficult questions that arise concerning the allocation of income to diverse investors are properly foreign to the trust area, where rules have not developed to accommodate the varied forms of commercial investment and no express economic substance requirement limits the allocation of income for tax purposes. These considerations prompted the proposed regulations, and we believe continue to require, as a general rule, that trust status be denied to investment trusts with multiple classes of ownership.

S.1959 and S.1978

The proposed multiple class trust regulations, and the consequent failure of attempts to market multiple class mortgage pools in the grantor trust format, have no doubt prompted the legislative initiatives represented by S.1959 and S.1978. The Treasury Department supports the general objectives of the sponsors of S.1959 and S.1978, and we hope that this hearing begins a mutual effort to resolve the issues in this area. Thus, we would welcome the opportunity to work with this Subcommittee as well as industry representatives to develop rules which insure that income from the underlying mortgages in a multiple class pool is properly allocated and reported to investors. To assist in this process, we would like to offer some preliminary views on technical aspects of S.1959 and S.1978.

Overall Structure. Although S.1959 and S.1978 would appear to have common objectives, there are potentially significant differences in their proposed treatment of multiple class mortgage pools. In general, S.1959 allows the issuer to elect to treat the issuance of interests in a pool of mortgages as a sale

of the mortgages to the investors. Investor interests in such pools are taxed as debt obligations and new rules are provided that specify the manner in which income from such obligations is to be reported. S.1978, on the other hand, treats the issuer of interests in a pool of mortgages as well as pools of various other types of debt instruments as a grantor trust. The application of the grantor trust rules to investors is not specified, however, leaving uncertain the manner in which income from the underlying obligations would be allocated.

Although S.1959 and S.1978 each treat the issuer as having transferred beneficial ownership of the mortgages, and thus leave the issuer free of any continuing tax liability with respect to the mortgages, we prefer the approach of S.1959 for a number of reasons. Most importantly, we believe it necessary that the manner in which mortgage income is allocated to investors be specified in any legislation granting tax exemption for the issuer. Moreover, we do not believe it appropriate that the necessarily technical rules for the taxation of investors in multiple class arrangements be developed in the context of the rules for the taxation of grantor trusts.

We also believe it is appropriate that, as under S.1959, multiple class arrangements for which the issuer is granted tax exemption be limited to debt obligations in the nature of real estate mortgages or mortgage-backed securities. Although multiple class pools of auto loans, lease receivables, corporate bonds, and various other obligations would appear closely similar in concept to multiple class mortgage pools, we believe it appropriate to proceed with some caution in this area. Thus, we believe it appropriate that we gain experience with multiple class mortgage pools before extending the concept of issuer level tax exemption to multiple class pools of other debt obligations. Moreover, because of real estate mortgages' typically long term and significant incidence of prepayment, they present the most pressing case for the allowance of multiple class arrangements.

Taxation of Investors. S.1959 amends the original issue discount provisions of the Internal Revenue Code to provide specific rules for the accrual of original issue discount on a mortgage-backed security when prepayments on the underlying obligations shorten the maturity of the interest. The existing original issue discount rules are uncertain in this area, providing only that if an intention to call an obligation prior to maturity exists at the time the obligation is issued, any gain upon redemption of the obligation (not in excess of the unamortized discount) is ordinary income. The scope of this rule is unclear, particularly as regards prepayments based on contingencies outside the control of either the issuer or holder of the obligation.

At present, we believe most taxpayers accrue original issue discount with respect to an obligation that may be prematurely retired based on the obligation's stated maturity. In cases

where prepayments are likely, this approach bases the obligation's yield on an unrealistic assumption as to its probable term, and thus results in a deferral of income for the holder, as well possible conversion of interest income to capital gain. For example, assume that an investor purchases for $88 the right to receive $100 at the end of two years and that, although based on a contingency not within the control of the issuer and holder, the holder anticipates prepayment of the obligation at the end of one year. Assuming a two year maturity, $5.81 of original issue discount accrues in year one and $6.19 of original issue discount accrues in year two. If the tax treatment of the holder is based on the stated maturity of the obligation and it prepays at the end of year one, the holder will only be charged with $5.81 of total original issue discount and the excess (i.e., $6.19) will be treated as capital gain (assuming the obligation is a capital asset and it is issued by a corporation). Since the obligation's price would ordinarily reflect the anticipated prepayment, the reliance on stated term understates the obligation's expected and actual yield and results in undertaxation of the holder.

The fast-pay, slow-pay structure of a multiple class mortgage pool effectively converts obligations that ordinarily are issued without discount, i.e. the underlying mortgages, into a series of obligations that do bear original issue discount. Since the expectation of prepayments is a principal reason multiple class mortgage pools are formed, any legislation addressing the taxation of such pools should also address the effect of anticipated or actual prepayments on the proper accrual of original issue discount. At least two basic approaches to this problem exist. One is to assume initially a maturity for the debt instrument based on market expectations as to prepayments on the underlying obligations. The other approach is to assume initially that no prepayments will be made, but to provide for subsequent adjustments as prepayments actually occur.

The market expectations approach would presumably require determination of an obligation's expected maturity based in some manner on its sale price. This approach may be theoretically correct, since if workable it produces a taxable yield to the investor that is consistent with the probable and anticipated economic return on the obligation. If subsequent market fluctuations or other factors cause actual prepayments to depart from the expected pattern of prepayments, the resulting economic gains or losses are properly treated as capital items.

Whatever its conceptual merit, the market expectations approach is likely not administratively feasible. Investor expectations are not easily derived from the price paid for an interest in a mortgage pool. The price paid for such interests reflects not only prepayment assumptions, but also judgments as to credit risks and future interest rates (during the expected term). Because the maturity and yield of an obligation are interdependent, an infinite number of prepayment assumptions may

be consistent with the price an investor paid for an interest. Moreover, although various sources compile and publish data on prepayment experience with respect to certain types of mortgages, this historical information may not accurately reflect current prepayment assumptions.

Presumably because of the difficulty in taking account of prepayment expectations, S.1959 takes the alternate approach of requiring adjustments to the accrual of original issue discount as prepayments occur. Under S.1959, the accrual of original issue discount on investors' interests is initially based on the stated maturity of the underlying mortgages. When a prepayment on an underlying mortgage is received, shortening the maturity of the investors' interests, investors accrue additional original issue discount equal to the increase in the present value of the stream of payments resulting from the prepayment (discounting at the original yield based on the stated maturity). In subsequent taxable years, the investor accrues original issue discount on the remaining payments at the original yield.

The following example will illustrate the application of S. 1959. Assume that investors A and B purchase interests in a mortgage pool which is composed of two mortgages. One mortgage is scheduled to pay $100 after two years and the other $100 after three years. Both investors are entitled to receive $100 but, in the event of a prepayment, A's interest will be retired first. Assume that A purchases his interest for $85.73 and that B purchases his interest for $75.13. Assume further that the payment scheduled to be received at the end of year three is in fact prepaid at the end of year one and, thus, A's interest is retired at that time; as a further result of the prepayment, B's interest will be retired no later than at the end of year two. Under S.1959, A and B would have the following tax consequences in year one. A has total original issue discount of $14.27, representing $6.86 of original issue discount which accrued in year one without regard to the prepayment, and an additional $7.41 of original issue discount attributable to the prepayment. B has total original issue discount of $15.67, which represents $7.51 of original issue discount which accrued in year one without regard to the prepayment and $8.26 of original issue discount attributable to the prepayment. A's additional original issue discount represents the unaccrued discount remaining when his interest is retired; B's additional original issue discount is the amount of discount which would have accrued in year two, but which has been accelerated because the maturity of his interest has been shortened by one year.

Although the adjustment approach resolves the potential mischaracterization of prepayment gain that may occur under present law, it does not remove the potential for deferral of income. Thus, the rate at which original issue discount accrues is still based initially on an assumption that payments will be received as scheduled, despite the near certainty that some mortgages in the pool will prepay. As noted previously, one

solution to the problem of deferral, assuming a maturity based on investors' expectations, is probably not feasible. Another possible approach to this problem would be to impose an interest charge on the original issue discount which is accelerated upon a prepayment. This is among the issues Treasury would like to explore with this Subcommittee and industry representatives.

In addition to providing rules for adjusting the accrual of original issue discount, S.1959 also requires investors, when the entity elects to treat the issuance of interests as a sale of the underlying mortgages, to include an additional amount in income equal to the excess of the amount of income which the entity would have realized had it remained taxable on the underlying mortgages over the aggregate amount of original issue discount accruing to the investors. This "greater of" method (i.e. the aggregate income to investors is equal to the greater of the income accruing on their interests in the pool or the income that would accrue to a single holder of the underlying mortgages) is intended to prevent a net loss of revenue from the creation of a multiple class mortgage pool. Without this feature, the current positively sloped yield curve would result in accrual of income on interests in a multiple class pool that is slower in the aggregate than the accrual of income to a single holder of the underlying mortgages.

The following example illustrates this phenomenon. Assume a debt instrument will pay $100 at the end of year one and $100 at the end of year two. Assume the fair market value of the debt instrument as a whole is $173.55 (i.e., a 10 percent overall yield), but that the fair market value of the year one payment is $91.32 (i.e., a 9.5 percent yield) and the fair market value of the year two payment is $82.23 (i.e., a 10.28 percent yield). The original issue discount which accrues on the whole debt instrument in year one is $17.36 and in year two is $9.09. By contrast, the original issue discount which accrues on the separate components of the debt instrument is as follows: in year one, original issue discount of $17.13 (i.e., $8.68 with respect to the year one payment and $8.45 with respect to the year two payment) accrues and, in year two, original issue discount of $9.32 accrues. The example illustrates that when, as is currently true, the yield curve is positively sloped, accruing discount based on the separate yields of the various components of a debt instrument will, in the aggregate, result in slower income inclusion than accrual of discount based on the overall yield of the whole bond. The separate components ultimately accrue the same total amount of original issue discount, but a portion of it is deferred to later periods.

The "greater of" rule contained in S.1959 is a departure from the normal rules which govern the purchaser of an original issue discount obligation. The rule may well be appropriate in this context, given that S.1959 or similar legislation could dramatically expand the volume of mortgages placed in multiple class pools. Although this expansion may produce greater

efficiency in the secondary mortgage market, it cannot be permitted to occur at the cost of any significant loss in revenue. In this regard, we are currently studying the revenue effects of S. 1959, and will apprise this Subcommittee when our analysis is complete.

Compliance and Other Issues. Although I will not address them in depth, a number of other issues concerning the taxation of investors must be resolved before an issuer could appropriately be exempted from tax on the mortgages in a multiple class pool. For example, S.1959 does not address the characterization of gain upon the sale of an investor's interest. The absence of an express rule in this respect could allow an investor to defeat the proposed adjustment mechanism by selling his interest at a capital gain. In addition, we are concerned that S.1959 fails to treat subsequent holders of multiple class interests in the same manner as subsequent holders of stripped coupons and bonds are treated under current law. Finally, significant questions remain concerning the proper treatment of contingent interests in a pool of debt instruments.

A final positive aspect of S.1959 is that it would repeal a variety of existing exemptions from the income reporting requirements and require that an issuer of interests in a mortgage pool report taxable income to all investors. We support this aspect of S.1959, and believe that a broad reporting requirement is an important adjunct to whatever rules are adopted for determining investors' income.

To summarize the Treasury Department's views with regard to S.1959 and S.1978, let me repeat that we hope the efforts initiated by you, Mr. Chairman, and by Senator Cranston and others will move forward. We offer our support for these efforts and pledge to work with this Subcommittee and industry representatives to achieve a practical solution to the tax issues in this area.

Environmental Zones

Let me turn briefly to S.1839, which would deny a number of generally available tax benefits with respect to activities conducted in "environmental zones." The tax benefits that would be denied include: accelerated depreciation; investment tax credit; exempt status with regard to the at-risk rules; percentage depletion; expensing of oil and gas intangible drilling costs and mining exploration and development costs; capital gains for timber, coal, and iron ore; deductions for soil and water conservation and land clearing; and the tax exemption for industrial development bonds. Environmental zones are specified areas that are of Federal environmental concern, but that are not formally part of a Federal system such as the National Park System or similar systems.

Although we are sympathetic with the objectives of this legislation, we question whether it is appropriate to control private activity in environmental zones through the tax code rather than through direct regulation. Use of the tax laws for such purposes could involve substantial administrative complexity, and would likely either discourage some activities that pose no environmental threat or result in a complex set of rules identifying activities that are appropriately exempt. Our current efforts to reform and simplify the tax system argue that we not burden the code with additional provisions designed to achieve non-tax policy objectives.

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TREASURY

FOR IMMEDIATE RELEASE

February 3, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 7,035 million of 13-week bills and for $ 7,010 million of 26-week bills, both to be issued on February 6, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 8, 1986			:	26-week bills maturing August 7, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	6.95%	7.17%	98.243	:	7.04%	7.40%	96.441
High	7.00%	7.22%	98.231	:	7.07%	7.43%	96.426
Average	6.99%	7.21%	98.233	:	7.06%	7.42%	96.431

Tenders at the high discount rate for the 13-week bills were allotted 29%.
Tenders at the high discount rate for the 26-week bills were allotted 13%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 43,435	$ 43,435	:	$ 33,745	$ 33,745
New York	20,265,280	5,859,185	:	17,751,450	5,489,880
Philadelphia	31,375	31,375	:	17,645	17,645
Cleveland	49,570	47,745	:	28,295	28,295
Richmond	51,795	51,795	:	60,940	60,940
Atlanta	64,915	52,770	:	68,670	64,320
Chicago	1,514,655	305,250	:	1,746,690	654,470
St. Louis	100,450	65,450	:	95,180	60,830
Minneapolis	14,005	14,005	:	19,635	19,635
Kansas City	55,340	55,340	:	65,590	65,590
Dallas	45,755	42,205	:	31,940	27,590
San Francisco	1,616,680	105,040	:	1,140,430	101,430
Treasury	361,095	361,095	:	386,015	386,015
TOTALS	$24,214,350	$7,034,690	:	$21,446,225	$7,010,385
Type					
Competitive	$21,218,390	$4,388,730	:	$18,251,970	$4,166,130
Noncompetitive	1,182,835	1,182,835	:	998,455	998,455
Subtotal, Public	$22,401,225	$5,571,565	:	$19,250,425	$5,164,585
Federal Reserve	1,586,025	1,236,025	:	1,550,000	1,200,000
Foreign Official Institutions	227,100	227,100	:	645,800	645,800
TOTALS	$24,214,350	$7,034,690	:	$21,446,225	$7,010,385

1/ Equivalent coupon-issue yield.

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FOR RELEASE AT 4:00 P.M.

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DEPARTMENT OF THE TREASURY

February 4, 1986

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,000 million, to be issued February 13, 1986. This offering will result in a paydown for the Treasury of about $325 million, as the maturing bills are outstanding in the amount of $14,331 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, February 10, 1986. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,000 million, representing an additional amount of bills dated May 16, 1985, and to mature May 15, 1986 (CUSIP No. 912794 KF 0), currently outstanding in the amount of $15,290 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,000 million, to be dated February 13, 1986, and to mature August 14, 1986 (CUSIP No. 912794 KZ 6).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing February 13, 1986. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,470 million as agents for foreign and international monetary authorities, and $3,488 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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.

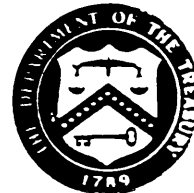
Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS



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

FOR IMMEDIATE RELEASE
February 5, 1986

Statement by Secretary of the Treasury
James A. Baker, III
at the Press Briefing on the
FY 1987 Budget
February 5, 1986

We seek to build on the foundation of the solid economic performance that has already taken place. The current economic expansion has now moved into its fourth year and shows few signs of slackening. Growth was relatively slow at some times during 1985, but by year-end the economy was gaining momentum.

Some favorable features of last year's economic performance deserve at least passing mention.

- o Consumer price inflation at 3.8 percent remained in the 3.8 to 4 percent range for the fourth year in a row, and is down sharply from the double-digit rates of 1980.

- o Employment has risen strongly in the current expansion, by more than 9 million people. The unemployment rate has been reduced to below 7 percent and further progress is expected.

- o Last year's financial market performance was also encouraging. Record amounts of credit flowed to private borrowers, despite the persistence of large Federal budget deficits. Short-term interest rates are down on average by about 1/2 percentage point in the past year while many of the long-term rates are down by about two percentage points. The prime rate is down to 9-1/2

percent, the lowest rate in 7 years. Ideally, we would like to have seen interest rates come down even further than they have.

All of this added up to a year of solid economic performance in 1985. The stage has been set for sustained expansion in output, jobs and income. This is one of the most important prerequisites for improving the budget picture, as well as the financial security of the American people. During the current expansion, strong economic growth has been achieved in a much less inflationary environment than in the late 1970's. We must strive to extend that good record into the future.

The Administration forecast, upon which Chairman Sprinkel will comment, calls for 4 percent real growth during the four quarters of 1986. This would seem to be a reasonable expectation. The consensus private forecast has been a little lower, around 3 percent. But the latest economic numbers may well be causing some upward adjustment in the private forecasts.

The inflation outlook is also relatively promising, although the fall in the external value of the dollar will eventually begin to exert a little upward pressure.

The Federal Reserve obviously needs to remain alert to the needs of both the domestic and international financial situations. While they never lack for critics and there is always room for disagreement on the wisdom of some of their specific actions, it seems to me that the Federal Reserve has been doing a good job recently.

* * *

I would like to turn briefly now to the influence of the international economy on our economic and fiscal situation. As a result of intensified efforts at promoting a favorable convergence of economic performance among the major industrial countries, we have seen some improvement in the world economy. We hope to build on the progress this year and to see stronger growth abroad. That trend would have a favorable impact on trade and economic growth in the United States.

Exchange markets have recognized these developments. Well over half of the dollar's rise on a real trade-weighted basis against other industrial countries from the end of 1980 to last winter's peaks has been reversed. This is good news for U.S. industry and agriculture. The U.S. trade deficit is likely to level off later this year. These developments should contribute to U.S. growth and to a more sustainable medium-term pattern of trade and current account balances. The G-5 meeting last

September contributed to these developments. Our recent meeting in London showed that all countries were working to continue efforts for sustainable growth.

Another favorable development has been the downward movement in world petroleum prices. Although not without its costs, on balance this should increase growth and lower inflation in most of the world.

* * *

There are two major items on this year's fiscal agenda: deficit reduction and tax reform.

The large budget deficits that we face are due to excessive Federal spending. Certainly it is not because the American people are undertaxed. As shown in the chart attached to my statement, receipts are running a bit above the long run historical average as a share of GNP. Despite frequent claims to the contrary, the 1981 Reagan tax cuts are not responsible for our current fiscal difficulties.

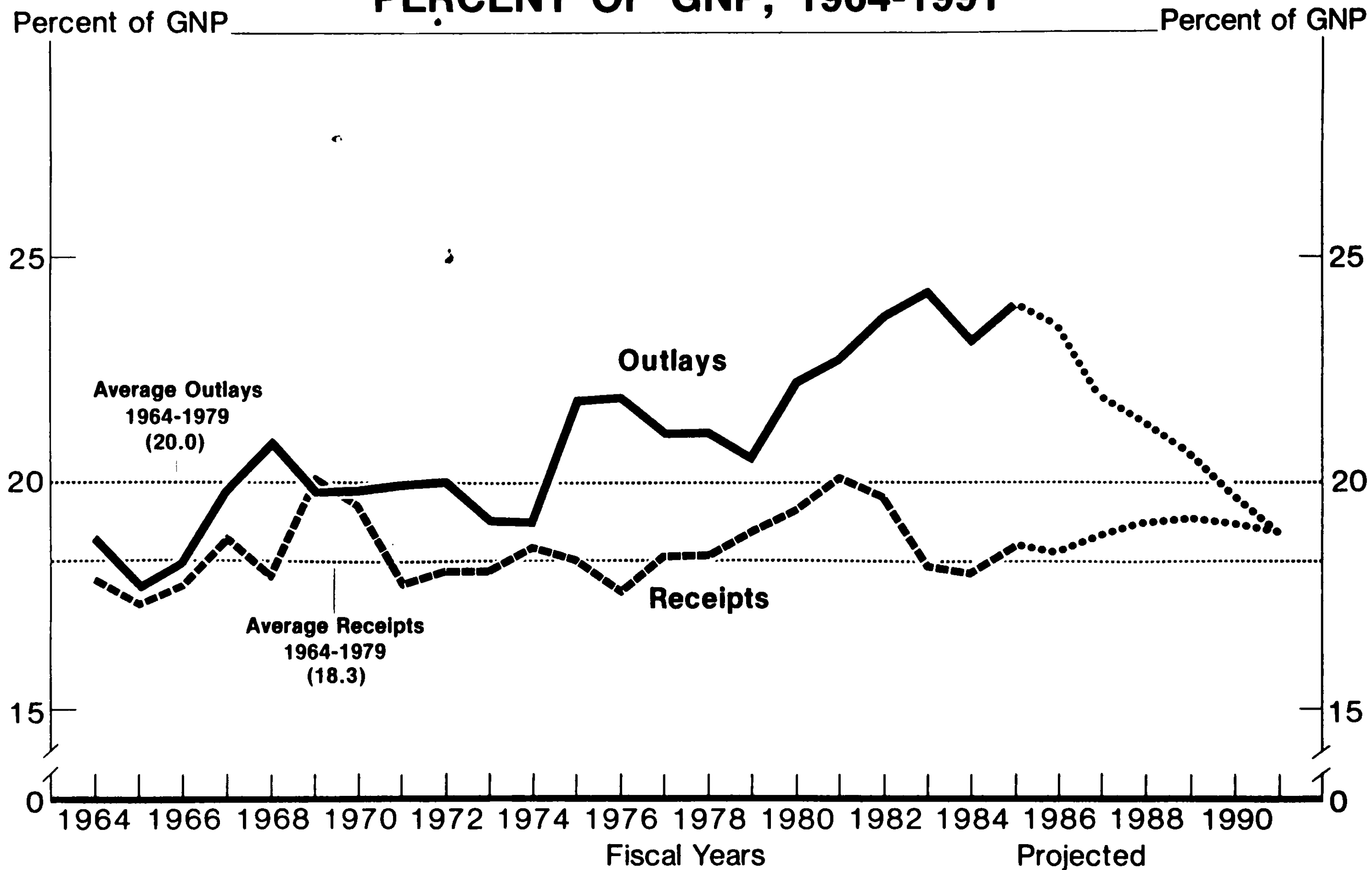
Our problems are on the outlay side of the budget, and that is where the corrective action needs to be taken. Congress shares this view. It has debated this issue and has passed the Gramm-Rudman-Hollings bill to cut the deficit by cutting growth in spending.

The reduction in the growth of expenditure required to balance the budget by fiscal year 1991 will not be easy, but the effort deserves strong bipartisan support. It can be done the hard, crude way, via sequestration across the board. Or it can be done more rationally and selectively, with respect for appropriate priorities. The President's budget is carefully drawn to meet the Gramm-Rudman targets while preserving essential programs of the highest national priority.

The only alternatives to the domestic spending cuts emphasized in the President's budget are to raise taxes, to lower defense spending, or to cut social security benefits, none of which are acceptable. There should be no illusion that tax increases will somehow provide an easy way out. The President has expressed his views on this issue very clearly. He is firmly opposed to damaging the economy by increasing taxes. Defense, which is the most essential duty of the Federal government, must be maintained. So must the social safety net, including Social Security and entitlement programs for the needy.

Our other major domestic policy priority is to achieve meaningful tax reform legislation. The bill passed last year by the House of Representatives is a good start but not a final product.

Tax reform remains a top priority item on the President's agenda. We will work in a bipartisan spirit to achieve meaningful tax reform this year. But let me be very clear that the President will not compromise on matters of principle and he will not permit tax reform to degenerate into a tax increase in disguise.



Note: Outlays include off-budget federal entities.

January 22, 1986 A54a

TREASURY NEWS

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

For Release Upon Delivery
Expected at 1:30 P.M.
February 6, 1986

Testimony of The Honorable James A. Baker, III
Secretary of the Treasury
Before the
House Appropriations Committee
February 6, 1986

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the state of the economy and the new budgetary path. The major economic objectives of the Administration have been described by President Reagan in his State of the Union Message. Further details on this year's economic and budgetary outlook will be provided this afternoon by CEA Chairman Sprinkel and Budget Director Miller. My remarks are an overview of the current situation.

We seek to build on the foundation of the solid economic performance that has already taken place. The current economic expansion has now moved into its fourth year and shows few signs of slackening. Growth was relatively slow at some times during 1985, but by year-end the economy was gaining momentum.

Some favorable features of last year's economic performance deserve at least passing mention.

o Consumer price inflation at 3.8 percent remained in the 3.8 to 4 percent range for the fourth year in a row. A table attached to my prepared statement shows the steady progress that has been made since 1980 when all of the measures of price performance were rising in the double-digit range.

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- o Employment has risen strongly in the current expansion, by more than 9 million people. The unemployment rate has been reduced to below 7 percent and further progress is expected. The U.S. economy continues to display great job-creating ability.

- o Last year's financial market performance was also encouraging. Record amounts of credit flowed to private borrowers, despite the persistence of large Federal budget deficits. Short-term interest rates are down on average by about 1/2 percentage point in the past year while many of the long-term rates are down by about two percentage points. The prime rate is down to 9-1/2 percent, the lowest rate in 7 years. Ideally, we would like to have seen interest rates come down even further than they have.

All of this added up to a year of solid economic performance in 1985. The latest economic information is generally favorable. Employment, retail sales, industrial production, personal income, residential construction, new orders and the leading indicators were all rising strongly at year end. The stage has been set for sustained expansion in output, jobs and income.

Sustained economic expansion is one of the most important prerequisites for improving the budget picture, as well as the financial security of the American people. During the current expansion, strong economic growth has been achieved in a much less inflationary environment than in the late 1970's. We must strive to extend that good record into the future.

The Administration forecast, upon which Chairman Sprinkel will comment, calls for 4 percent real growth during the four quarters of 1986. This would seem to be a reasonable expectation. The consensus private forecast has been a little lower, around 3 percent. But the latest economic numbers may well be causing some upward adjustment in the private forecasts. Those of us who advise the President on these matters feel that the current Administration projections are inherently reasonable although we also recognize that economic forecasting is at best an uncertain art.

The inflation outlook is also relatively promising, although the fall in the external value of the dollar will eventually begin to exert a little upward pressure.

The Federal Reserve obviously needs to remain alert to the needs of both the domestic and international financial situations. While they never lack for critics and there is always room for disagreement on the wisdom of some of their specific actions, it seems to me that the Federal Reserve has been doing a good job recently.

* * *

I would like to turn briefly now to the influence of the international economy on our own economic and fiscal situation. As a result of intensified efforts at promoting a favorable convergence of economic performance among the major industrial countries we have seen some improvement in the world economy. We expect to build on the progress this year. On balance, we expect stronger European and LDC domestic demand growth this year as they continue the process of shifting from export-led to domestic-led growth. Unfortunately there may be some weakening in Japanese growth as the previous stimulus from the trade sector is sharply reduced.

Exchange markets have recognized these generally favorable developments. The decline of the dollar since its peak last winter has been substantial. The yen is at a seven-year high against the dollar. Well over half of the dollar's rise on a real trade-weighted basis against other industrial countries from the end of 1980 to last winter's peaks has been reversed. This is good news for U.S. industry and agriculture. The U.S. trade deficit is likely to level off later this year. These developments should contribute to a more sustainable medium-term pattern of trade and current account balances. The G-5 meeting last September contributed to these developments. Our recent meeting in London showed that all countries were working to continue efforts for sustainable growth.

Another favorable development has been the downward movement in world petroleum prices. Although not without its costs, on balance this should strengthen growth and lower inflation in most of the world. A few countries and firms will experience problems, but with the U.S. debt initiative and a strongly growing world economy these problems can be handled.

While the international debt situation has continued to improve, economic growth in many debtor countries has remained unsatisfactory, and requires greater emphasis on structural policy reforms within those nations, buttressed by additional international financial support. As you know, the United States proposed last October at Seoul, Korea a "Program for Sustained Growth", involving mutually reinforcing actions by the debtor countries, the international financial institutions, and the commercial banks. The response has been very encouraging, with broad statements of support from the major bank groups in the U.S. and other key creditor nations, from the multilateral institutions and in principle from many of the debtor nations.

* * *

There are two major items on this year's fiscal agenda: deficit reduction and tax reform.

The President's budget for fiscal 1987 provides a detailed plan, satisfying the requirements of the Gramm-Rudman-Hollings legislation, by which a balanced budget can be achieved by fiscal 1991. The large budget deficits that we currently face are due to excessive Federal spending. Certainly it is not because the American people are undertaxed. As shown in the chart attached to my prepared testimony, receipts are running a bit above the long run historical average as a share of GNP. Despite frequent claims to the contrary, the 1981 Reagan tax cuts are not responsible for our current fiscal difficulties.

Our problems are on the outlay side of the budget, and that is where the corrective action needs to be taken. Congress shares this view. It has debated this issue and has passed the Gramm-Rudman-Hollings bill to cut the deficit by cutting growth in spending. Outlays will continue to grow in absolute terms along the path projected in the new budget, but the rate of advance will be reduced significantly. Between FY 1985 and FY 1991, nominal Federal outlays would rise on average about 3 percent per year. In the prior six-year period, 1979-1985, the rate of growth was about 11 percent per year. Along the path projected in the new budget, Federal outlays would decline steadily as a ratio to GNP from 24 percent in 1985 to about 19 percent in 1991.

Receipts will be growing strongly in absolute terms as the economy itself grows, but receipts would remain close to a 19 percent ratio to GNP -- slightly above historical experience. Receipts are projected to rise by about an average 7-1/2 percent annually between FY 1985 and FY 1991, close to the 8 percent rise averaged in the previous 6 year period. With receipts growing normally and outlay growth restrained to a lower path, the budget will move into balance by 1991.

The reduction in the growth of expenditure required to balance the budget by fiscal year 1991 will not be easy, but the effort deserves strong bipartisan support. It can be done the hard, crude way, via sequestration across the board. Or it can be can be done more rationally and selectively, with respect for appropriate priorities. The President's budget is carefully drawn to meet the Gramm-Rudman-Hollings targets while preserving essential programs of the highest national priority.

The only alternatives to the domestic spending cuts emphasized in the President's budget are to raise taxes, to lower defense spending, or to cut social security benefits, none of which are acceptable. There should be no illusion that tax increases will somehow provide an easy way out. The President has expressed his views on this issue very clearly. He is firmly opposed to damaging the economy by increasing taxes. Defense, which is the most essential duty of the Federal Government, must be maintained. So must the social safety net, including social security and entitlement programs for the needy.

The outlay reductions would be expected to bring down interest rates with a beneficial impact on the entire economy. In addition, lower interest rates and a declining budget deficit will moderate the rapid rise in interest expense that has developed. This will free up funds for growth in essential programs.

The time has come to reduce what has clearly become an excessive rate of growth in Federal spending and to move toward a balanced Federal budget.

* * *

Our other major domestic policy priority is to achieve meaningful tax reform legislation. The bill passed last year by the House of Representatives is a good start but not a final product. Our primary concerns are the following:

- o the bill lowers marginal tax rates but the top individual rate of 38 percent and the corporate rate of 36 percent are still too high;
- o the bill raises the personal exemption to $2000, but to only $1500 for taxpayers who itemize deductions;
- o the bill fails to maintain the cost of capital at sufficiently low levels to promote economic growth.

The Senate Finance Committee has begun consideration of tax reform and the Administration has pledged its full cooperation in improving the House legislation. Our major desired changes include:

- o full $2000 personal exemptions for both itemizers and nonitemizers, at least for lower and middle-income taxpayers;
- o provision of adequate capital cost recovery allowances and the protection of those allowances against inflation;
- o a top tax rate no higher than 35 percent.

Tax reform remains a top priority item on the President's agenda. We will work in a bipartisan spirit to achieve meaningful tax reform this year. But let me be very clear that the President will not compromise on matters of principle and he will not permit tax reform to degenerate into a tax increase in disguise.

Conclusions

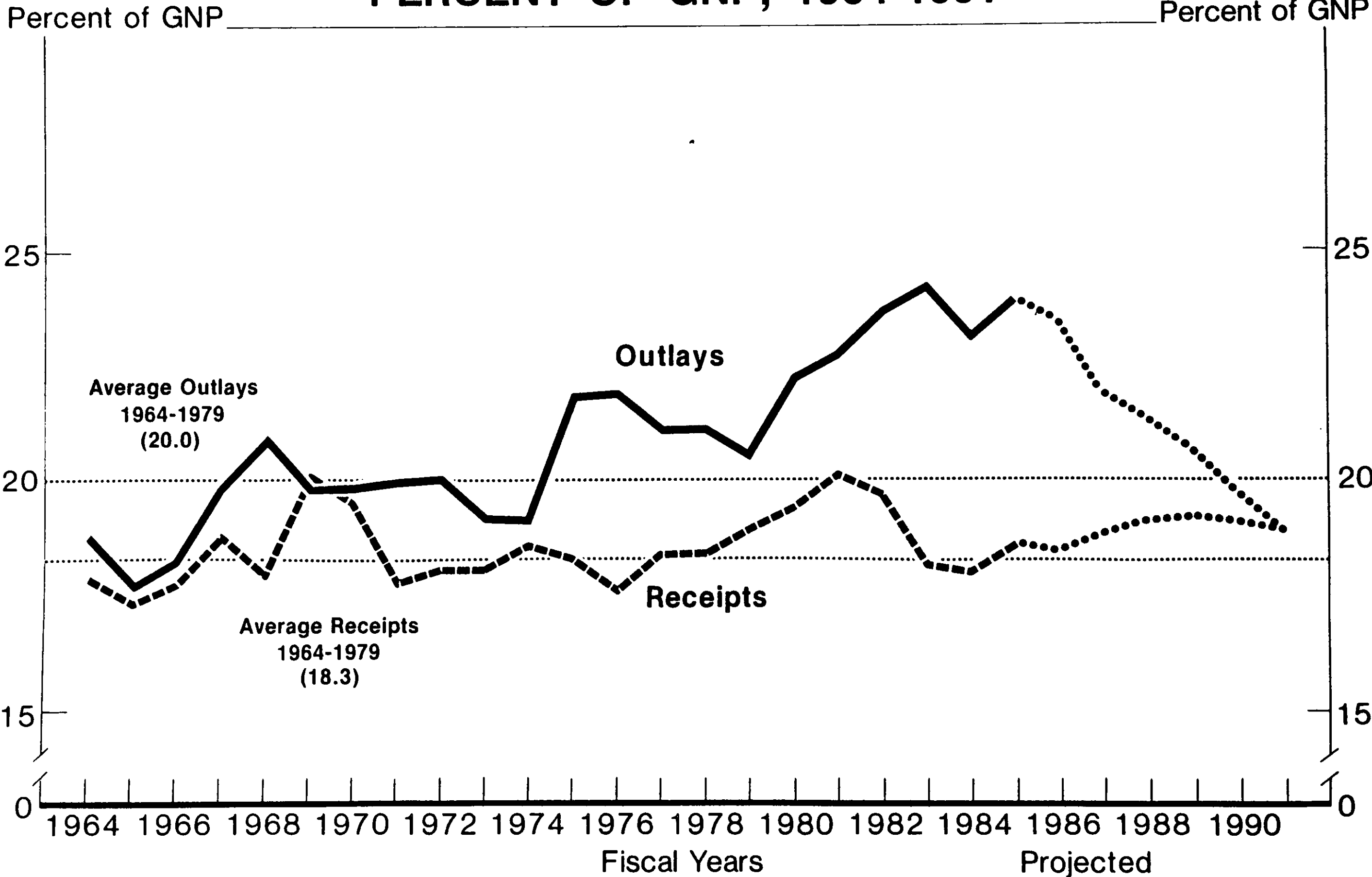
The U.S. economy turned in a solid showing last year and the outlook this year is for stronger real growth without much increase in inflation. Internationally, as well, there was progress during 1985 and we will be working to build on that foundation. Our major domestic agenda items are reduction of an excessive rate of growth in Federal spending as we move toward a balanced budget, and meaningful tax reform for the American people. We think that both of these efforts deserve and will receive strong bipartisan support.

RECENT PROGRESS AGAINST INFLATION

(percent change, annual rate, during period indicated)

	1980	1981	1982	1983	1984	1985
GNP: Implicit price deflator	9.9	8.7	5.2	3.5	4.1	3.1
Fixed-weighted basis	9.8	8.5	5.0	3.8	4.2	3.5
Consumer price index	12.4	8.9	3.9	3.8	4.0	3.8
Producer price index (wholesale prices)	11.8	7.1	3.7	0.6	1.7	1.8

Note: Fourth quarter to fourth quarter for GNP deflator, December to December for CPI and PPI.



Note: Outlays include off-budget federal entities.

January 22, 1986 A54a

TREASURY NEWS

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FOR IMMEDIATE RELEASE FEB 6 9 55 AM '86 February 4, 1986

DEPARTMENT OF THE TREASURY

RESULTS OF AUCTION OF 3-YEAR NOTES

The Department of the Treasury has accepted $9,005 million of $18,693 million of tenders received from the public for the 3-year notes, Series Q-1989, auctioned today. The notes will be issued February 18, 1986, and mature February 15, 1989.

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

	Yield	Price
Low	8.07%	99.817
High	8.14%	99.635
Average	8.11%	99.713

Tenders at the high yield were allotted 92%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 57,235	$ 27,235
New York	15,985,985	7,654,305
Philadelphia	34,700	34,700
Cleveland	67,845	65,845
Richmond	93,820	93,580
Atlanta	66,505	66,505
Chicago	1,183,230	494,150
St. Louis	114,405	96,405
Minneapolis	43,190	43,185
Kansas City	110,020	109,520
Dallas	29,465	29,465
San Francisco	903,810	287,210
Treasury	2,905	2,905
Totals	$18,693,115	$9,005,010

The $9,005 million of accepted tenders includes $807 million of noncompetitive tenders and $8,198 million of competitive tenders from the public.

In addition to the $9,005 million of tenders accepted in the auction process, $322 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $886 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

B-453

TREASURY NEWS

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

FOR RELEASE
FEBRUARY 4, 1986

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DEPT. OF THE TREASURY

STATEMENT BY THE HONORABLE DAVID C. MULFORD
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS
U.S. TREASURY DEPARTMENT

BEFORE THE
ORION ROYAL BANK CONFERENCE
THE PLAISTERERS HALL
LONDON, ENGLAND

FEBRUARY 4, 1986

The U.S. Debt Initiative:

Toward Stronger Growth in the Debtor Nations

The international debt crisis continues to pose one of the greatest challenges for the world economy and financial system since the Great Depression.

As with all mega-problems confronting world governments, the debt crisis has that element of monolithic insolubility which brings out our worst frustrations. Like an elephant, it is easy to see, hard to get your arms firmly around it, and very unproductive to face the entire bulk of the issue head-on.

This group does not need to hear statistics, but let me illustrate. By the end of 1985, the external debt of the developing nations had grown to nearly $900 billion -- $200 billion higher than at the onset of the debt crisis in early 1982, and nearly triple their debt in 1977. Forty percent of this debt is in Latin America; approximately half, or about $425 billion, is owed to the private commercial banks. Interest charges alone on these vast sums presently amount to $75 billion a year, and total debt service prior to reschedulings amounts to some $140 billion annually, representing by any measure a significant share of debtors' total export earnings.

Commodity markets generally remain depressed and per capita income in many Latin countries remain below earlier levels. Inflation rates in Latin America are two and a half times as high as they were five years ago and investment has fallen sharply.

Managing the debt problem, let alone eventually solving it, requires two critical operating assumptions. First, we must honestly recognize that there are no easy, all encompassing global solutions. Second, no matter how overpowering the problem appears in its totality, we must focus our efforts on those elements of the problem that are soluble and work to expand those beachheads once they are established.

Herein lies the importance of the U.S. debt initiative, rapidly becoming known as the "Baker Plan." It recognizes the fundamental need for growth and places the objective of increased growth at the center of the debt strategy. Perhaps in our preoccupation with balance of payments crises, standby programs, reschedulings and new bank financing we have let our eyes fall from the far hills to the rough terrain before us. In doing so, we have not kept two very simple facts firmly in our minds.

> First, without growth there can be no solution to the debt problem. Countries will never be able to repay any portion of the debt they are carrying unless they can accumulate resources -- and export earnings -- at a faster pace than they are accumulating debt.

> Second, without economic reform, no amount of money -- whether derived from external borrowing, financial aid, or inflationary domestic pump-priming -- will produce sustained growth.

We have only to observe the pernicious problem of capital flight, which in recent years has been equivalent to virtually all new bank lending to Latin America, to see the futility of throwing more money at the problem.

Credible reform by the debtor nations will improve their growth prospects, but economic adjustment and growth must be financed. The other two elements of the debt initiative provide for the sources of this finance: Net new lending by commercial banks and enhanced flows from the international financial institutions. These three mutually reinforcing elements form the working heart of the debt strategy.

I will return in a moment to more detailed comments on the U.S. debt initiative. But first, it is important to underline the fact that the debt initiative does not operate in a vacuum or in isolation from other critical economic issues. Indeed, the debt initiative was launched by Secretary Baker shortly after

the broad-based initiative taken by the Group of Five industrial nations at their meeting last September 22nd in New York. The Plaza statement recognizes that solid, low inflation growth and open markets in the industrial countries are an essential prerequisite for stronger growth in the developing nations.

The individual policy intentions announced by the Group of Five in their September statement focused in particular on reducing structural impediments to growth, cutting excessive government expenditures, avoiding protectionist trade measures, and improving the investment climate as a stimulus to private sector initiative and growth. These measures are essential to consolidate and improve growth prospects within the industrial economies, but will also help to increase the demand for debtor nations' exports, while over time reducing both nominal and real interest rates -- passing on the benefits of growth. In agreeing on these policy measures, the industrial nations also keyed in on the kinds of policies which we now recognize are equally important for growth-oriented reform in the developing nations themselves.

Since September, there has been a substantial decline in the dollar and a further reduction in interest rates, both of which are positive developments. Prospects for world growth are improving and there is now better convergence of sound, low-inflation performance in the world's major economies. The United States is implementing a credible deficit reduction program and is deeply engaged in tax reform. If other key industrial nations do their part, improving domestically generated growth, I see greater scope for reduced inflation and further reductions in interest rates over time.

The response to the U.S. debt initiative from all quarters has been positive and confirms our conviction that the focus of the initiative on these three main elements is essential. There are differing views on whether the amount of resources we have called for is sufficient, and many question whether the necessary reforms in the international financial institutions and the debtor nations can be accomplished. Others believe there should be greater involvement on the part of creditor governments. But our focus on the three main elements for resolving the debt problem is widely agreed by all key participants to hold the greatest hope for realistic forward momentum.

What, then, needs to happen to make the strategy work?

First, the debtor nations must reform their economies so that they can grow. While the developing nations as a whole have undertaken commendable efforts to deal with their debt problems during the past three years, those efforts have fallen short of producing lasting reform within their domestic economies.

They have failed to control adequately government budget deficits. While some progress has been made in reducing inflation, in most countries inflation remains extremely high. Overvalued exchange rates, subsidies and negative interest rates also frustrate the ability of the market to allocate efficiently resources within debtor economies. Lack of confidence in the prospects for renewed domestic growth, as a result, has contributed to serious capital flight.

A number of important structural reforms are needed to lay a firm foundation for stronger growth and to reverse the capital flight which has plagued these economies. These include the privatization of public enterprises, the development of more efficient domestic capital and equity markets, growth-oriented tax reform, improvement of the environment for both domestic and foreign investment, trade liberalization and the rationalization of import regimes. I recognize that many of these touch on sensitive political issues, while their benefits may become visible only over the longer term. Such reform is difficult, and takes time. Moreover, it has to be financed, but to attract that finance it must be credible, with reasonable prospects for long term success.

Second, new efforts are required by the international financial institutions. I would underscore at the outset that the IMF must continue to play its very important role in the overall debt strategy. Enhanced roles for the World Bank and the other multilateral development banks will be supplemental to the IMF's role, not a substitute for it.

We have asked the IMF to give more thought to growth-oriented policies and this is being done. But given the IMF's central mission (which is not that of a development institution), and its need to concentrate its resources on relatively short balance of payments programs, the Fund's contribution to longer-term reform efforts will necessarily be somewhat limited and indirect.

The World Bank's mission, on the other hand, is more strongly focused on longer-term development issues and it already has experience in addressing some of the types of structural problems that most debtor countries face. Most of the World Bank's new lending will be fast-disbursing sectoral and structural adjustment loans. We believe the World Bank has ample capacity to increase such lending by some $2 billion per year over the next three years and to concentrate that lending more heavily on the large debtors with credible reform programs. We are also prepared, if all the participants in the strategy do their part and there is a demonstrated increase in the demand for quality lending above these levels, to consider a general capital increase for the World Bank.

An expanded role for the World Bank will also require important policy and procedural changes in the Bank. This is a difficult but indispensible exercise, for two reasons:

- First, it is hard to change large, mature organizations with firmly established bureaucracies.
- Second, an expansion of fast-disbursing loans must, and I repeat must, be accomplished without dilution of the quality of World Bank lending.

Indeed, it will be essential to improve the conditionality of lending within the World Bank if sectoral lending is to be increased. This is even more true for the Inter-American Development Bank. Any substantial increase in fast-disbursing lending by either Bank which fails to maintain loan quality will result in a serious risk of over-exposure and a diminished international credit standing for both of these important international institutions.

It will also be essential for the IMF and the World Bank to establish a closer working relationship. I realize this is easy to say, and hard to accomplish. But the member governments of both institutions must insist that some pragmatic method of closer cooperation be developed if economic reform in the debtor nations is going to be credible enough to command additional resources from private banking institutions. Private lenders must be convinced that the long-term structural reforms which have not been sufficiently emphasized in the past will actually take place this time.

This brings me to the third element of the strategy, what you, the commercial banks, contribute. Commercial banks in virtually all of the major creditor nations have now indicated their willingness to support the U.S. debt initiative and to provide net new lending to the debtor nations. If the other two parts of the strategy are implemented in a credible manner, the banks can only gain from providing additional financing which improves the creditworthiness of their existing clients. The banks know that without growth in the debtor nations -- and an improved ability to earn foreign exchange -- they cannot expect to be repaid, nor, to put it bluntly, can they expect to continue favorable earnings on assets of declining quality. The banks also know that growth must be financed in large part from private capital resources.

The banking community therefore should concern itself with helping both the debtor nations and the international financial institutions to develop the necessary reforms and procedures for implementing the debt strategy. Continuing calls for "more details" on the U.S. debt initiative before the banks will actually commit any funds are not helpful. I find such comments

disingenuous. They suggest to me that the banks are waiting for some indication that we will support stronger government or World Bank guarantees for bank lending, a reduction in the World Bank's "preferred creditor status" relative to the commercial banks, perhaps for rescheduling purposes, or some sharing of that status for commercial bank loans undertaken in conjunction with the World Bank or the Inter-American Development Bank. Among U.S. banks there is also something of a campaign for regulatory changes to encourage lending.

While such "wish lists" on the part of the banks may be understandable, we do not intend to support them to induce increased bank lending. Banks should not be enticed unwillingly into new lending to debtor nations. If sound growth-oriented policies are adopted by the debtor countries, the banks will benefit from improvements in the quality of outstanding loans.

Traditionally, banks have worked with troubled clients, because they have believed it to be in their own self-interest. The present international debt situation is no different. Indeed, there is more at stake for the participating banks in all the creditor nations, because they share the same international and interdependent financial system. Also, their sovereign nation clients are not going to go out of business. There _is_ a future for international banking.

The commercial banks are being called upon to increase their exposure by what they know to be a modest 2.5 to 3 percent annually, while the World Bank is being asked to increase its lending by 50 percent above current spending levels, equivalent to an annual increase in total exposure of approximately 20 percent. The provision of government or World Bank guarantees would essentially transfer risk to governments, voiding even this modest increase in commercial bank exposure.

What we need instead is for the commercial banks to pitch in and do their share, thereby helping both the debtor countries and the international financial institutions to move the process forward, a process which I emphasize is vital to the interests of the banks themselves.

The other comment or question I hear is: "When is the debt initiative going to begin"?

The answer very simply is that it _has_ begun. It is an ongoing process. Virtually all of the debtor countries are participating in this process, some more fully and successfully than others. There is no need for countries to formally embrace the plan. Indeed, the very word "plan" is misleading because the debt initiative does not prescribe a specific blueprint or plan for implementation in every detail by each and every debtor

country. Rather, it provides a framework, or a grouping of mutually reinforcing elements, to enable cooperative action in support of the debtors' own efforts to improve their growth prospects.

Some of the larger debtors will need to take advantage of all of the elements of the strategy: an IMF program, enhanced sectoral loans from the multilateral development banks, and new money packages from the commercial banks. Mexico and Argentina are already working in this direction.

Other nations already have certain elements of the strategy in place. Their most immediate need is to take advantage of the new resources being provided by the multilateral development banks by adopting effective structural reforms. We are working with the World Bank to effect these flows in a relatively short period of time. Ecuador is perhaps the most advanced of this group of countries, but others such as Colombia, Uruguay, and the Ivory Coast are also making good progress and will no doubt unlock further resources from these institutions in the coming months.

Obviously some extremely complex problems must still be resolved in the implementation process. The actual nature of reforms to be adopted by the debtor nations is under active negotiation in individual cases. The timing and manner in which the three main elements of the initiative will fit together also needs to be carefully worked out, and will vary for different cases.

For example, will the completion of an IMF standby program with a debtor country trigger immediate commercial bank lending, even though important parts of that country's reforms are still under negotiation with the World Bank and important resources are not yet pledged to fill any financing gap? Clearly this issue cannot be solved in a vacuum. It is not merely a theoretical exercise as many observers seem to think, but is a real negotiating issue with political and market implications that must be worked out in practice.

We may wish to consider, in some cases, whether close cooperation between the IMF and the World Bank can produce agreement with the debtor country on a medium-term policy framework which would identify the kinds of policy measures needed to achieve sustainable economic growth. Perhaps in such cases action on certain key reforms could help to trigger initial disbursements by the IMF, the World Bank, and the commercial banks, with subsequent actions and proven progress in implementing prior commitments required for further disbursements. Such an approach could provide a useful bridge to the adoption of more comprehensive economic programs over a longer period, because we recognize that fundamental and credible reform is above all a political process, requiring

time, steady application, and ingenuity to show results. This kind of an approach could also help to assure both early flows of funds and that all three elements of the strategy are moving together in support of growth-oriented policy reforms.

One particularly important hurdle we must get over is capital flight, which provides a sensitive barometer for the implementation of credible reform. Debtor nations and the banking community alike have suffered from capital flight in recent years. This is perhaps the ultimate proof that the debt problem can only be addressed through the adoption of fundamental economic reforms that restore public confidence in the debtor nations themselves.

No set of unilaterally declared policies by debtor nations vis-a-vis their creditors, absent credible internal reforms, will staunch or reverse these financial expressions of insecurity. If the right economic measures begin to be implemented, there also must be imaginative solutions designed to help restore capital resources which have already fled these countries. In a resource-starved world, restoration of flight capital may actually provide the largest potential source of capital for these nations. The banking community needs to focus on imaginative solutions that contribute to progress in this area, just as they need to look for debt/equity swap opportunities. Such actions hold out the possibility of eventually reducing demands for new lending, and this is clearly in the banks' own interest.

Finally, the banking community also has an interest in the development of more sensible and open investment policies within the debtor nations. Total investment as a share of GDP has declined sharply in most of the Latin debtor nations since 1980. The U.S. private direct investment position in the seven largest Latin economies was no greater at the end of 1984 than it was at the end of 1981. A sound investment climate is essential not only to attract foreign capital, but also to encourage increased levels of domestic savings, and the repatriation of funds which have moved offshore. Commercial banks understand the private sector investment business and their help is needed to encourage the necessary economic reforms.

With your help and support, I am confident that the strategy we have proposed can provide a needed impetus to growth in the debtor nations.

Conclusion

Implementation of the U.S. debt initiative is already well underway. This year, however, will be a critical one in determining whether our joint efforts can successfully establish a strong foundation for future growth.

If the international financial institutions fail to insist on credible reform -- or the debtor nations fail to undertake such reform -- the strategy will not work, and commercial banks will not provide supportive financing. The crisis we face can then only deepen, not only for debtor and creditor countries, but for the commercial banks as well.

On the other hand, if the debtor nations are serious about restoring growth to their economies -- and I believe they are -- 1986 can provide a watershed of opportunity to begin working productively toward that goal.

Whether we proceed along one path or the other will depend on the outcome of individual negotiations between the debtor countries, the international financial institutions, and the banks. That process is now underway and will be a continuing one. We may see some milestones keyed to specific countries. But we should not be looking for a series of major events in rapid succession.

The debt situation involves a broad range of economic, financial and political elements, all of which need to be addressed. The recent decline in interest rates should help save debtor countries $7 - $8 billion on their commercial bank debt this year alone. Lower oil prices will also help many of the debtor nations, but may for several be extremely difficult. Our strategy must be able to adapt to these changing circumstances and to provide additional financing where needed, while assuring that all of the participants continue to do their part.

The process is evolutionary. It will take time and will require patience, cooperation, political sensitivity, practical ideas, and steady application of the disciplines within the debt strategy to restore growth to the debtor nations. That is the challenge before us, and the only real solution to the debt crisis.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE February 5, 1986

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RESULTS OF AUCTION OF 10-YEAR FOREIGN-TARGETED NOTES

The Department of the Treasury has accepted a total of $1,001,000 thousand of the $1,585,000 thousand of tenders received from eligible bidders for the 10-year foreign-targeted notes, Series B-1996, auctioned today. The notes will be issued February 18, 1986, and mature February 15, 1996.

The interest rate on the notes will be 8-7/8% 1/ per annum, payable annually. The range of accepted competitive bids, and the corresponding prices at the 8-7/8 % interest rate are as follows:

	Yield 2/	Price 4/
Low	9.04%	98.940
High	9.16%	98.182
Average	9.12% 3/	98.434

Tenders at the high yield were allotted 40%.

1/ Established in the auction of the companion domestic issue.

2/ Based on an annual interest payment.

3/ This yield is equal to 8.92 % on a semiannual payment basis, which is .05 basis points lower than the average yield on the companion domestic note.

4/ In addition to the auction price, accrued interest of $0.73958 per $1,000 for February 15, 1986, to February 18, 1986, must be paid.

B-456

TREASURY NEWS

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DEPARTMENT OF THE TREASURY

FOR IMMEDIATE RELEASE February 5, 1986

RESULTS OF AUCTION OF 10-YEAR DOMESTIC NOTES

The Department of the Treasury has accepted $7,013 million of $15,765 million of tenders received from the public for the 10-year notes, Series A-1996, auctioned today. The notes will be issued February 18, 1986, and mature February 15, 1996.

The interest rate on the notes will be 8-7/8%. 1/ 2/ The range of accepted competitive bids, and the corresponding prices at the 8-7/8 % interest rate are as follows:

	Yield	Price 3/
Low	8.94%	99.573
High	8.99%	99.249
Average	8.97%	99.379

Tenders at the high yield were allotted 76%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 5,892	$ 5,892
New York	13,430,438	5,869,518
Philadelphia	3,960	3,960
Cleveland	38,913	38,913
Richmond	75,158	49,038
Atlanta	29,300	26,820
Chicago	1,277,535	771,615
St. Louis	98,835	82,835
Minneapolis	12,788	12,548
Kansas City	37,275	36,535
Dallas	7,471	7,471
San Francisco	747,077	107,557
Treasury	782	782
Totals	$15,765,424	$7,013,484

The $ 7,013 million of accepted tenders includes $453 million of noncompetitive tenders and $6,560 million of competitive tenders from the public.

In addition to the $ 7,013 million of tenders accepted in the auction process, $350 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $200 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

1/ The minimum par amount required for STRIPS is $1,600,000. Larger amounts must be in multiples of that amount.

2/ This interest rate, payable on an annual basis, will also be applied to the 10-year foreign-targeted notes auctioned today.

3/ In addition to the auction price, accrued interest of $0.73550 per $1,000 for February 15, 1986, to February 18, 1986, must be paid.

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE February 6, 1986

AMENDED RESULTS OF AUCTION OF 10-YEAR DOMESTIC NOTES

The amounts awarded in yesterday's auction of domestic 10-year notes to foreign and international monetary authorities and to Government accounts and Federal Reserve Banks for their own account were inadvertently reversed.

The press release should have shown $200 million as being awarded to Federal Reserve Banks as agents for foreign and international monetary authorities and $350 million to Government accounts and Federal Reserve Banks for their own account. All other particulars in the announcement remain the same.

B-458

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

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FOR IMMEDIATE RELEASE February 6, 1986

RESULTS OF AUCTION OF 30-YEAR BONDS

The Department of the Treasury has accepted $7,004 million of $17,766 million of tenders received from the public for the 30-year Bonds auctioned today. The bonds will be issued February 18, 1986, and mature February 15, 2016.

The interest rate on the bonds will be 9-1/4%. 1/ The range of accepted competitive bids, and the corresponding prices at the 9-1/4 % interest rate are as follows:

	Yield	Price 2/
Low	9.27%	99.795
High	9.29%	99.594
Average	9.28%	99.695

Tenders at the high yield were allotted 47%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 14,365	$ 365
New York	15,677,826	6,686,956
Philadelphia	204	204
Cleveland	41,275	1,275
Richmond	4,148	4,148
Atlanta	9,905	3,905
Chicago	1,243,504	215,504
St. Louis	78,407	62,407
Minneapolis	10,256	7,196
Kansas City	5,997	5,997
Dallas	4,283	1,283
San Francisco	675,862	14,862
Treasury	162	162
Totals	$17,766,194	$7,004,264

The $7,004 million of accepted tenders includes $331 million of noncompetitive tenders and $6,673 million of competitive tenders from the public.

In addition to the $7,004 million of tenders accepted in the auction process, $250 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

1/ The minimum par amount required for STRIPS is $800,000. Larger amounts must be in multiples of that amount.

2/ In addition to the auction price, accrued interest of $0.76657 per $1,000 for February 15, 1986, to February 18, 1986, must be paid.

(THIS ANNOUNCEMENT IS EMBARGOED FOR USE UNTIL
2:30 P.M. FEBRUARY 7, 1986)

FEBRUARY 7, 1986

ANNOUNCEMENT: LIBYAN SANCTIONS

PRESIDENT REAGAN LAST MONTH ANNOUNCED CERTAIN RIGOROUS, MEASURED AND FOCUSSED RESPONSES TO THE QADHAFI REGIME'S INVOLVEMENT IN AND SUPPORT FOR INTERNATIONAL TERRORISM. THESE PEACEFUL MEASURES HAVE THREE GOALS:

-- TO END VIRTUALLY ALL DIRECT U.S. ECONOMIC ACTIVITY WITH LIBYA;

-- TO CAUSE ALL UNAUTHORIZED AMERICANS TO LEAVE LIBYA, AND NOT TO TRAVEL THERE IN THE FUTURE; AND

-- TO MAKE CLEAR TO QADHAFI THAT HE MUST PAY A PRICE FOR HIS REGIME'S SUPPORT OF TERRORISM.

IN ADDITION, WE ENCOURAGED OTHER NATIONS TO TAKE ACTIONS WHICH SUPPORT THESE GOALS.

AMERICAN CITIZENS AND BUSINESSES HAVE RESPONDED ENCOURAGINGLY TO THE PRESIDENT'S ORDERS; IMPLEMENTATION OF THEM IS PROCEEDING SMOOTHLY:

-- WE BELIEVE THAT MOST AMERICANS HAVE NOW LEFT LIBYA AND THAT ALL BUT A FEW OF THOSE WHO REMAIN ARE FAMILY MEMBERS OF LIBYAN CITIZENS. EXCEPTIONS FOR HUMANITARIAN PURPOSES HAVE BEEN GRANTED TO PERSONS IN THIS CATEGORY. THE OTHERS WHO HAVE CHOSEN TO STAY IN LIBYA ARE SUBJECT TO PROSECUTION UNDER U.S. LAW.

(MORE)

-- UNLICENSED TRAVEL BY AMERICANS TO LIBYA HAS BEEN PROHIBITED.

-- ALL DIRECT IMPORTS AND EXPORTS BETWEEN THE UNITED STATES AND LIBYA HAVE BEEN PROHIBITED (WITH CERTAIN HUMANITARIAN EXCEPTIONS, SUCH AS DONATIONS OF FOOD, CLOTHING AND MEDICINE).

-- NEW COMMERCE BY AMERICAN CITIZENS AND BUSINESSES WITH LIBYA HAS BEEN PROHIBITED. GRANTS AND EXTENSIONS OF CREDIT BY AMERICANS TO LIBYA HAVE BEEN BARRED. AND LARGE AMOUNTS OF LIBYAN GOVERNMENT FUNDS HAVE BEEN BLOCKED.

IN IMPLEMENTING THE EXECUTIVE ORDERS FOR THE DIVESTITURE OF ASSETS OF U.S. COMPANIES IN LIBYA, THE SECRETARIES OF TREASURY AND STATE HAVE ADOPTED THE FOLLOWING PRINCIPLES:

1. AS A GENERAL RULE, ALL ACTIVITIES PURSUANT TO CONTRACTS AND OTHER ARRANGEMENTS BETWEEN U.S. NATIONALS AND LIBYA ARE TO BE TERMINATED IMMEDIATELY.

2. U.S. NATIONALS OWNING ASSETS IN LIBYA ARE FREE TO REMOVE SUCH PROPERTY, WHERE POSSIBLE, OR TO SELL IT TO LIBYA, TO LIBYAN NATIONALS OR, IF THE PROPERTY IS NOT FOR USE IN LIBYA, TO ANYONE ELSE.

3. IN EXCEPTIONAL CASES, WHERE ABANDONMENT OF CONTRACTS OR CONCESSIONS WOULD RESULT IN A SUBSTANTIAL ECONOMIC WINDFALL TO LIBYA, LIMITED EXTENSIONS ARE BEING GRANTED TO COMPANIES TO PREVENT WINDFALLS, ON STRICT CONDITIONS. THE CONDITIONS TO BE IMPOSED, WHICH WE ARE ANNOUNCING TODAY, INCLUDE:

-- AN OBLIGATION TO TERMINATE ALL DEALINGS AS SOON AS PRACTICABLE ON FAIR AND APPROPRIATE TERMS.

(MORE)

-- ALL PROFITS EARNED BY U.S. FIRMS IN LIBYA AFTER FEBRUARY 1 WILL BE PLACED IN AN ESCROW ACCOUNT UNDER U.S. GOVERNMENT CONTROL, FOR DISPOSITION ONLY AFTER EACH FIRM COMPLETELY TERMINATES ITS REMAINING ACTIVITIES IN LIBYA AND AS AGREED BY THE U.S. GOVERNMENT.

-- IN ADDITION, THE OIL COMPANIES MUST:

- o END ALL U.S. CORPORATE INVOLVEMENT IN OPERATING THE OIL FIELDS;
- o NOT DISTRIBUTE ANY LIBYAN CRUDE OIL THROUGH THE COMPANIES' TRANSPORTATION AND REFINING NETWORKS;
- o SELL THEIR "EQUITY" CRUDE ONLY "AT THE FLANGE" IN LIBYAN PORTS, NOT OUTSIDE LIBYA;
- o UNDERTAKE NO NEW ACTIVITIES OR OBLIGATIONS; AND
- o HOLD EXISTING ACTIVITIES TO THE MINIMUM NECESSARY TO SATISFY THEIR CONTRACTUAL OBLIGATIONS.

-- ALL COMPANIES GRANTED EXEMPTION LICENSES MUST REPORT TO THE TREASURY DEPARTMENT ON A FREQUENT PERIODIC BASIS ON THE PROGRESS OF THEIR NEGOTIATIONS FOR WITHDRAWAL FROM LIBYA.

THESE STRICT, LIMITED EXTENSIONS ARE BEING PERMITTED BECAUSE OTHERWISE THE COMPANIES INVOLVED MIGHT BE (1) SUBJECT TO CLAIMS THAT THEY HAD DEFAULTED ON THEIR CONTRACTS WITH LIBYA AND (2) FORCED TO ABANDON SUBSTANTIAL ASSETS IN LIBYA, INCLUDING SOME OIL CONCESSIONS HAVING UP TO 20 YEARS TO RUN. WE ESTIMATE THE POTENTIAL ECONOMIC WINDFALL TO QADHAFI TO BE $1 BILLION OR MORE.

WE WANT TO AVOID SUCH A WINDFALL FOR QADHAFI, WHICH WOULD BE INCONSISTENT WITH OUR OBJECTIVES.

TREASURY NEWS

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THE TREASURY

INTRODUCTORY STATEMENT BY

THE HONORABLE RICHARD G. DARMAN

THE DEPUTY SECRETARY OF THE TREASURY

BEFORE THE HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

SUBCOMMITTEE ON GOVERNMENT INFORMATION, JUSTICE AND AGRICULTURE

FEBRUARY 6, 1986

INTRODUCTION

Thank you for inviting me to appear before your committee today. It is a pleasure to have an opportunity to do so.

It is my understanding that the Committee is primarily interested in discussing drug interdiction. My introductory remarks, therefore, address:

(I) the Treasury Department's role in drug interdiction (through the Customs Service);

(II) the allocation of resources to the role; and

(III) the relationship of the resource allocation to the challenge of drug interdiction and to broader issues of drug policy and strategy.

Mr. Chairman, I am not by any reasonable stretch of imagination an expert in this field. I can, however, provide a Departmental perspective on the issues involved; and I am accompanied by the Commissioner of Customs, who can address detailed operational issues to the extent that they are of interest to the Committee.

After this brief introductory statement, we would look forward to answering your questions.

I. CUSTOMS ROLE IN DRUG INTERDICTION

The Customs role with respect to air and marine interdiction may be summarized as follows:

Air Program

The Customs Air Program has as its primary mission the detection, identification, interception, tracking, and apprehension of smuggler aircraft.

The current program is based upon the following general concepts:

- deterrence against air smuggling, achieved in conjunction with the provision of assistance to land and marine interdiction;
- integration of air interdiction and support functions;
- use of specialized aircraft to perform the roles of detection, interception, tracking and apprehension of low flying smugglers; and
- cooperation with the military, to the extent permitted by posse comitatus laws.

The Air Program has an operations division at Customs headquarters and operations centers East and West in the field. Headquarters is responsible for management, administration, and operational guidance, with the operations centers responsible for readiness and line management of the resources under their command.

Aviation units are deployed across the southern border, staffed to operate on the equivalent of a 5-day x 8-hour basis, with an authorized personnel strength of 385 positions. This authorized level includes 71 new positions allocated to the program in October 1985. Recruitment is in progress to fill the vacancies.

Recent initiatives in the Air Program have included the following:

- In September 1982, Customs acquired the use of the Air Force's Tethered Aerostat Radar System (TARS), at Cudjoe Key and Patrick AFB in Florida.
- In FY 1983, Customs received, from DOD, the first high-speed Black Hawk helicopter. Customs now has eight such helicopters.
- In FY 1983, Customs received the first of four P-3A detection aircraft. All four will be operational for the first time this year.
- In FY 1985, the Cariball Aerostat was placed in operation on Grand Bahamas Island, providing coverage of smugglers that overfly the Bahamas.
- In March 1986, the first CHET (Customs High Endurance Tracker) will be delivered, with the remaining seven trackers scheduled for delivery by the end of FY 1986. The CHETs will be used primarily for intercepting and tracking smuggler aircraft.
- Customs currently operates 80 aircraft (deployed as indicated on the table at the end of Section II).

Marine Program

The mission of the Customs Marine Program is to investigate, interdict, and apprehend violators that smuggle narcotics and contraband by commercial vessels, fishing vessels and pleasure craft.

The current Marine Program is based upon the following general concepts:

- integration of case investigations, threat analysis, intelligence and direct interdiction; and
- coordination of Air and Marine planning, in cooperation with local, state, and other Federal agencies.

The Marine Program faces a number of operational difficulties, including smugglers using the following modes of operation to evade Customs:

- small pleasure craft and speed boats -- which are easily available, and difficult to detect; small vessels off the coast of the Bahamas and the east coast of Florida -- which are increasingly used to receive airdrops; and professionally installed secret compartments in all types of vessels -- the use of which has significantly increased.

II. CUSTOMS INTERDICTION RESOURCES AND THE BUDGET

Budget Request

In the President's FY 1987 Budget, the Administration is seeking $756 million and 13,231 FTE for the Customs Service. Of this amount, $71.6 million is for the Air Program and $33.9 million is for the Marine Program.

U.S. CUSTOMS SERVICE
BUDGET AUTHORITY AND PERSONNEL
FY 1981 - FY 1987

	1981	1982	1983	1984	1985	est. 1986	req. 1987
BUDGET AUTHORITY							
All Other Customs	$458.4	$496.6	$536.6	$564.3	$617.4	$640.4	$650.6
Air	27.3	17.8	26.2	64.8	67.2	68.9	71.6
Marine	12.8	12.8	12.3	26.4	46.6	32.9	33.9
Total	$498.5	$527.2	$575.1	$655.5	$731.2	$742.2	$756.1
PERSONNEL							
All Other Customs	14,145	13,699	13,482	13,496	13,005	13,139	12,330
Air	153	153	165	250	314	385	385
Marine	148	147	150	347	427	472	516
Total	14,446	13,999	13,797	14,093	13,746	13,996*	13,231

* The 1986 personnel total above reflects Customs' reduced personnel level as a result of the Gramm-Rudman reduction. This number is in the Congressional materials that will be submitted by the Department to the Appropriations Committees. Note, the President's Budget does not allocate Gramm-Rudman reductions by object class so this number is not reflected in the President's Budget.

The requested levels for the Air and Marine programs for FY 1986 and FY 1987 will allow Customs to:

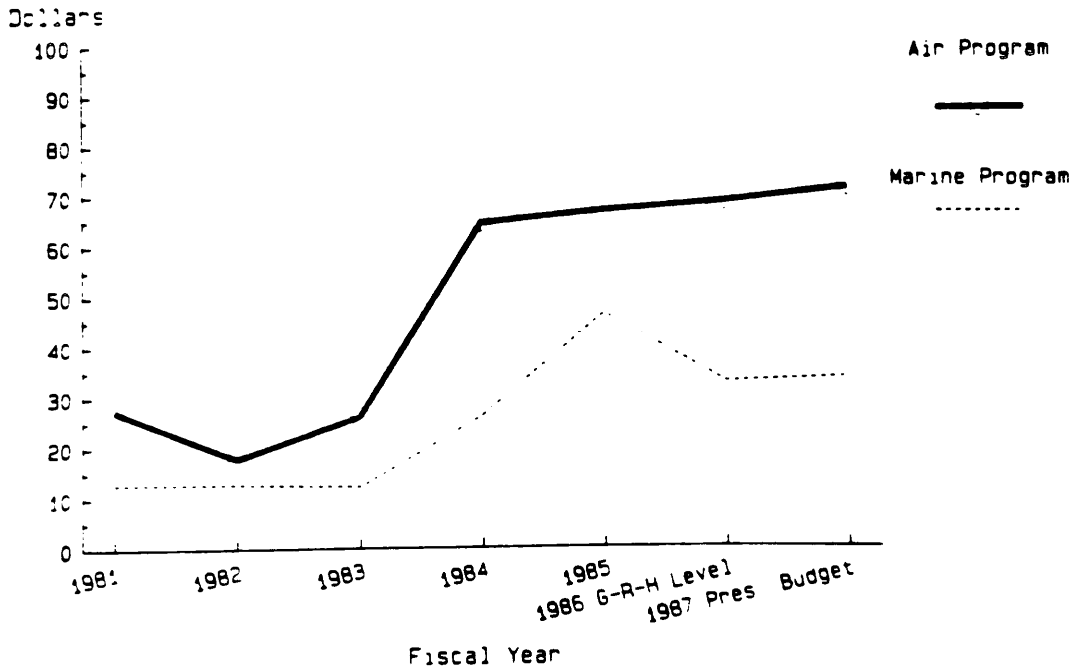
- bring on line an additional P3A detection aircraft in FY 1986 for a total of four in FY 1986 and FY 1987:
- bring on line and operate eight new high endurance tracker aircraft in FY 1986 for use in FY 1986 and FY 1987;
- continue development and improvement of Customs Command, Control, Communications and Intelligence capability;
- modify two C-12 marine support aircraft in FY 1986 for deployment in FY 1987, and modify two in FY 1987 -- for a total of four C-12's that will be deployed in FY 1987;
- take delivery of 40 "Blue Thunder" type high speed boats for the Marine program with all in operation in FY 1987.

Budget Trend

Spending authority for the Customs Air Program has increased from $17.8 million in FY 1982 to the proposed level of $71.6 million for FY 1987.

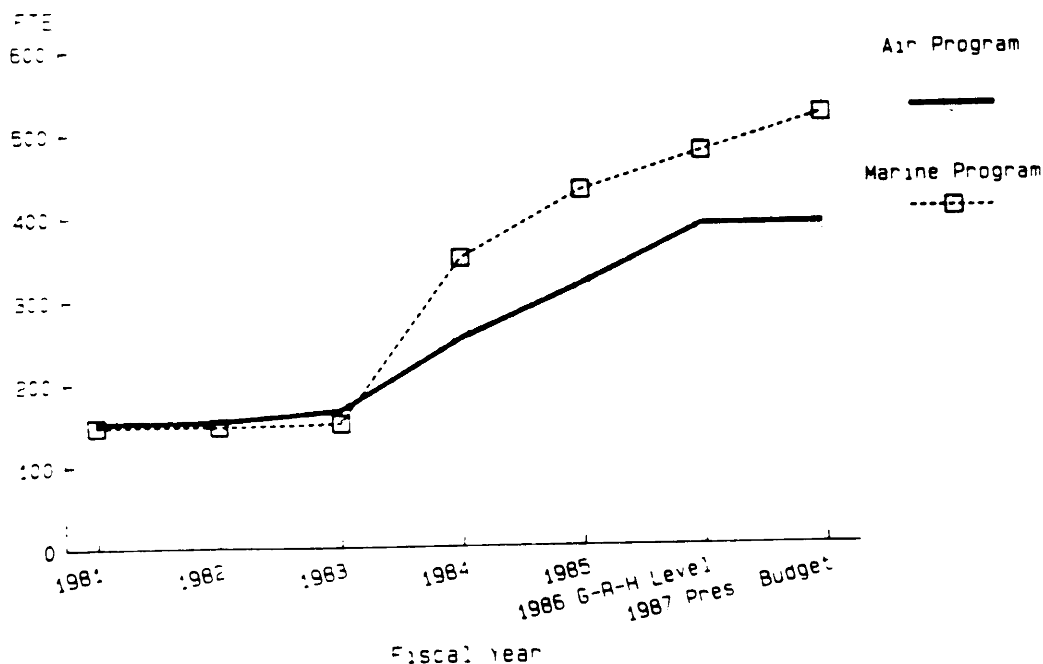
The FY 1987 request for the Air Program is four times the FY 1982 appropriated level. The Marine request is almost three times the FY 1982 level.

CUSTOMS AIR AND MARINE PROGRAMS
Budget Authority
($ in Millions)



Personnel Trend

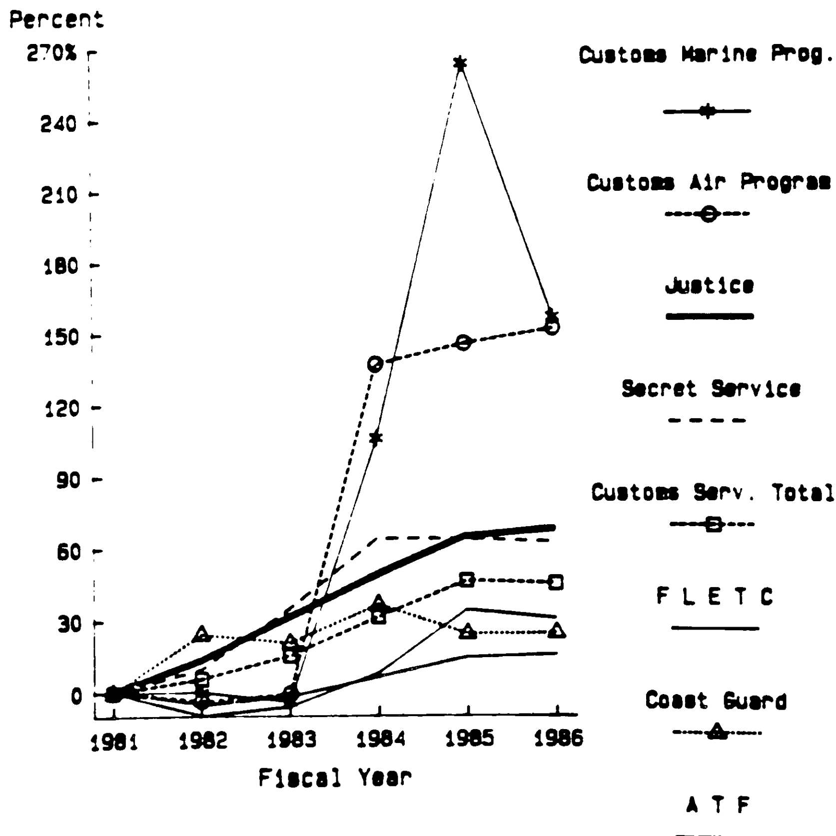
On a full-time equivalent (FTE) basis, staffing for the Customs Air Program has grown from 153 FTE in FY 1982 to nearly 400 FTE for FY 1986 and FY 1987. This increase represents a near tripling of Air Program personnel over the last four years (1982-86). Similar growth has occurred in staffing for the Customs Marine Program. From 150 FTE in FY 1983, the Marine Program has grown to 472 FTE this year and will increase to more than 500 FTE next year. This increase in Marine Program staffing represents more than a 200% increase over the last three fiscal years (1983-1986).



Comparative Law Enforcement Resource Trends

Air and Marine Program resources have increased at a greater rate than other Federal law enforcement programs between FY 1981 and FY 1986. The Department of Justice and Secret Service have increased by between 60-70%. The Air and Marine Program have increased by over 150%.

FUNDING TRENDS (1981 - 1986 BUDGET AUTHORITY)
Selected Law Enforcement Activities
Including Customs Air and Marine Programs

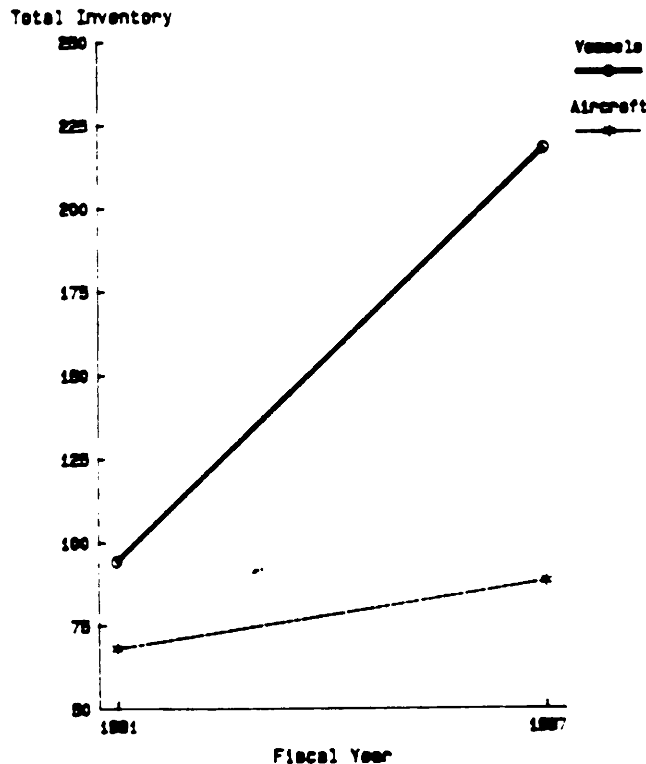


Budget Authority reflects amounts as contained in the FY 1986 President's Budget.

Air and Marine Assets (aircraft and vessels)

The increase in Customs budgetary resources for interdiction is reflected in a related increase in assets. The number of vessels deployed in the Marine program has more than doubled -- from 94 in FY 1981 to 218 in FY 1987. The number of Customs aircraft has also increased -- from 68 in FY 1981 to a projected 88 in FY 1987. (Note: The quality mix for both vessels and aircraft has also improved.)

U.S. CUSTOMS SERVICE
Number of Aircraft and Vessels in Inventory
FY 1981 and FY 1987



These air and marine assets have been deployed in rough proportion to the estimated threat -- as indicated by the following table and charts.

Customs Interdiction
Aircraft Distribution by Region
January 6, 1986

FUNCTION	MIA	JAX*	MSY	HOU	SAT	ELP*	TUC*	SAN*	TOTAL
DETECTION:									
P-3A			2				2		4
INTERCEPTION (UNITS):									
Citation II Citation I **	2	1	1		1		1		6
TRACKING (UNITS):									
Beechcraft King Air (B-200)	1		1		1	1			4
Beechcraft King Air (E-90)							1		1
OV-1C Mohawk				1					1
APPREHENSION (UNITS):									
AH-1G Cobra				1		2			3
UH-60A Black Hawk	2	1	1				2	2	8
SUBTOTAL	5	2	5	2	2	3	6	2	27

FUNCTION	MIA	JAX*	MSY	HOU	SAT	ELP*	TUC*	SAN*	TOTAL
MISC. SUPPORT AIRCRAFT: Twin	6***	8	3	3	3	2	2	4	31
Single-Engine	1	1	0	2	0	2	2	1	9
Helicopter	1	2	1	1	1	2	2	3	13
SUBTOTAL	8	11	4	6	4	6	6	8	53
TOTAL	13	13	9	8	6	9	12	10	80

* Includes Air Units
** One Citation I not included, not considered mission capable
*** One of these twins is dedicated for Marine Support

The following eight aircraft will be removed from the fleet as the CHET aircraft are received:

East Wing

2 - OV-1C Mohawks (Houston)
1 - Beechcraft A-60 (Jacksonville)
1 - Cessna 402 (Jacksonville)

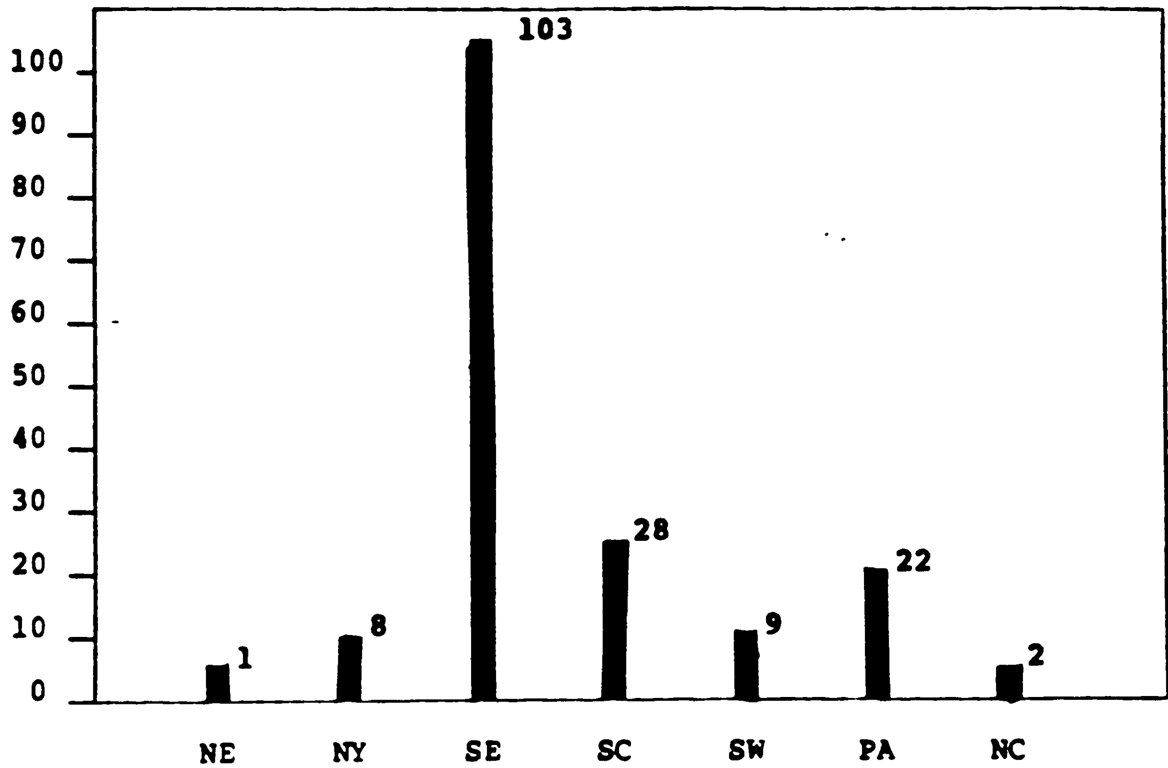
West Wing

1 - Piper PA-31 (San Antonio)
1 - Cessna 340 (San Diego)
1 - UH-1B (Tucson)
1 - Aero Commander 681 (San Diego)

Customs Interdiction

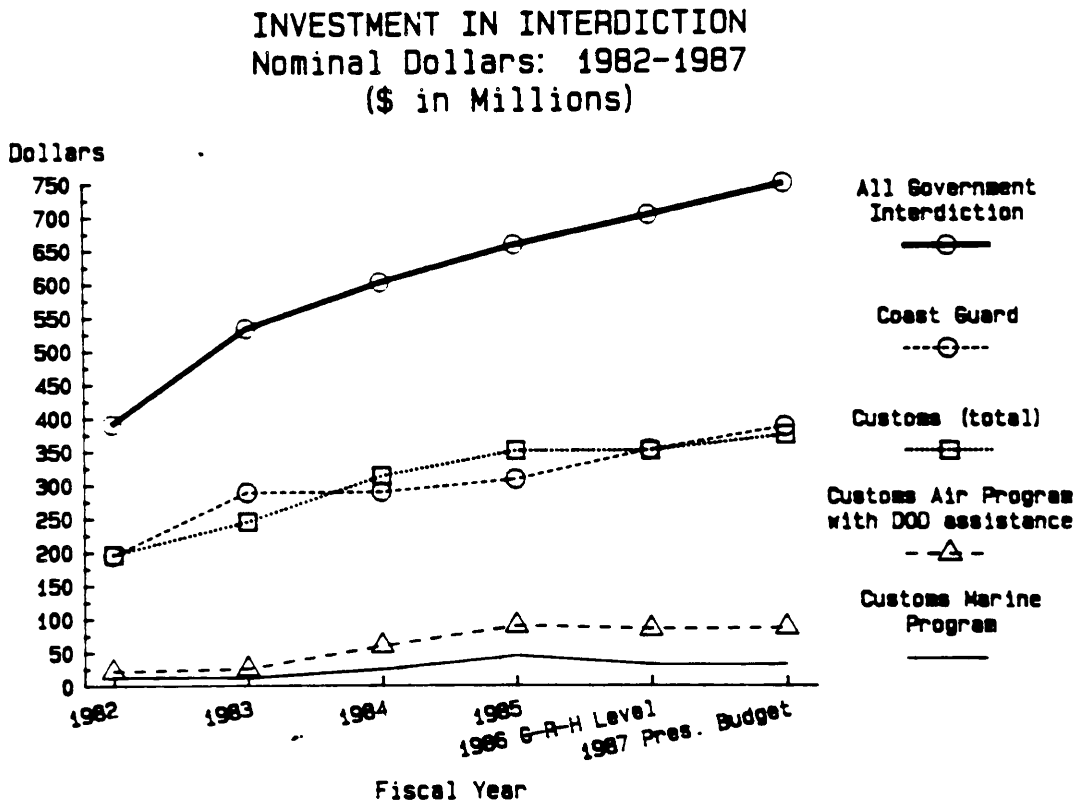
Vessel Distribution by Region

January 31, 1986



III. Resources in Relation to Strategy

Not only have Customs drug interdiction resources increased, so too has the Federal Government's overall investment in interdiction -- as indicated by the following chart.



What is less clear, unfortunately, is the appropriate relationship of this investment to the development and implementation of an optimal strategy for reducing drug abuse in America.

It is obvious, of course, that the retail value of certain drug seizures has increased. But it is signficiantly less obvious what relationship there is between this fact and ultimate U.S. drug use.. Seizures are definitively measurable; but drug use is not. It is subject to inherently fallible estimating. Interdiction rates, therefore, are highly arguable, and accordingly, meaningful measures of incremental returns on investment in interdiction are also arguable. This is the case whether one is comparing particular modes of interdiction or alternative levels of interdiction.

The analytic problem is compounded as one broadens the scope of analysis. And broaden the scope one must. OMB has estimated that for FY 1987, the President's Budget requests $1.808 billion for drug law enforcement. Of this, roughly 43% is for border interdiction -- compared with 24% for criminal investigations, 12% for corrections, 8% for federal prosecution, 8% for international narcotics control, 3% for intelligence, and 2% for state and local assistance. (These estimates involve a degree of judgment in classifying and allocating expenditures -- but the proportions are at least roughly indicative of broad relationships.) A very much smaller amount of money is invested in drug abuse prevention, and in related drug research. On the basis of what analysis I have seen, one cannot be fully satisfied that either the current or proposed distribution is an optimal allocation of limited resources.

My personal view is that the data and methodology are not yet up to the task of determining what _is_ an optimal allocation. And I would, therefore, place a high priority on more systematic analysis.

I recognize that in the face of a problem as serious as the drug problem -- the seriousness of which I would never wish to understate -- there is an understandable temptation to suggest: spend what it takes to eliminate the problem. Unfortunately, we (collectively -- as a society) do not now have sufficient available resources to do so. Our fiscal deficit has become its own form of addiction, and it, like other addictions, has the potential to threaten our society's health.

Given severe fiscal constraints and considerable uncertainty as to optimal resource allocation strategies for addressing the drug problem, we have decided essentially to stabilize the investment in Customs drug interdiction -- increasing the current deterrent capacity only marginally, while continuing to examine competing alternatives for incremental investment.

This is an approach that I know some will find frustrating. But while I fully sympathize with the sense of frustration -- we all want to see the tragedy of drug abuse eliminated -- I do believe that what we are recommending is, in the current context, a prudent approach.

Again, I thank you for the opportunity to present this perspective.

* * * * * *

TREASURY NEWS

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

LIBRARY, ROOM 5310

FEB 12 3 43 PM '86

DEPARTMENT OF THE TREASURY

FOR RELEASE AT 12:00 NOON   February 7, 1986

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $9,000 million of 364-day Treasury bills to be dated February 20, 1986, and to mature February 19, 1987 (CUSIP No. 912794 LX 0). This issue will provide about $475 million of new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $8,525 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Thursday, February 13, 1986.

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.

The bills will be issued for cash and in exchange for Treasury bills maturing February 20, 1986. In addition to the maturing 52-week bills, there are $14,704 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 currently hold $2,219 million as agents for foreign and international monetary authorities, and $5,670 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rate 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 $125 million of the original 52-week issue. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-1.

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Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, 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

LIBRARY, ROOM 5310

FOR IMMEDIATE RELEASE
February 10, 1986

CONTACT: ROBERT LEVINE
Phone: (202) 566-2041

FEB 13 8 21 AM '86
DEPT. OF THE TREASURY

TREASURY RELEASES JOINT REPORT FOR JAPAN TRADE TALKS ON MEDICAL EQUIPMENT AND PHARMACEUTICALS

The Department of the Treasury released today a special report on the results of U.S.-Japan trade talks in the area of medical equipment and pharmaceuticals. The talks, initiated in early 1985, were part of the market-oriented, sector-selective (MOSS) discussions. The talks yielded significant progress in creating a more open Japanese health care market by simplifying regulatory procedures, eliminating administrative delays, and increasing foreign access to Japanese regulatory authorities.

The Report on Medical Equipment and Pharmaceuticals Market-Oriented, Sector-Selective (MOSS) Discussions released today describes the Japanese health care market, outlines the problems foreign firms faced in entering and competing in that market, and identifies the agreed market-opening measures. Key issues addressed in the report include the trade effects of Japan's regulatory system for protecting public health and safety and its insurance system for reimbursing health care expenses. Given that Japan's National Health Insurance system covers nearly 100 percent of the Japanese population, the rules and procedures for reimbursing doctors, hospitals, and clinics are a central factor in the market entry of pharmaceuticals and medical devices.

The report, jointly prepared by the U.S. and Japan MOSS negotiating teams, also makes clear the commitment both sides have made to a meaningful follow-up process. The negotiating teams will continue to meet at a political level on a regular basis to review implementation of the agreed solutions and to resolve any additional issues that may arise.

The measures agreed to by the United States and Japan should encourage the entrance into the market of new producers and new products. The Japanese health care market is large and growing -- second only to that of the United States -- and of prime interest to major health care products firms.

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The interagency delegations of both sides met six times in 1985 to discuss and develop market-opening measures. The U.S. side was led by Assistant Secretary of the Treasury for International Affairs David C. Mulford and included representatives from the Treasury Department, the State Department, the Commerce Department, the Office of the U. S. Trade Representative, and the U.S. Food and Drug Administration. The Japanese side was led by Vice Minister of the Ministry of Health and Welfare Hitoshi Yoshimura and included representatives from that ministry and the Ministry of Foreign Affairs and the Ministry of Finance.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE

LIBRARY, ROOM 5310

February 10, 1986

FEB 13 8 21 AM '86

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,028 million of 13-week bills and for $7,017 million of 26-week bills, both to be issued on February 13, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 15, 1986			26-week bills maturing August 14, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	7.17%	7.40%	98.188	7.22%	7.60%	96.350
High	7.18%	7.41%	98.185	7.23%	7.61%	96.345
Average	7.18%	7.41%	98.185	7.23%	7.61%	96.345

Tenders at the high discount rate for the 13-week bills were allotted 67%.
Tenders at the high discount rate for the 26-week bills were allotted 68%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 66,570	$ 36,570	$ 67,725	$ 33,725
New York	21,811,635	6,085,760	19,847,510	5,973,125
Philadelphia	26,830	26,830	20,445	20,445
Cleveland	44,380	42,300	33,030	33,030
Richmond	50,860	50,860	61,815	50,715
Atlanta	50,620	38,220	135,155	91,160
Chicago	1,647,060	83,060	1,535,940	179,460
St. Louis	95,135	54,970	91,470	46,470
Minneapolis	50,320	14,320	51,230	15,230
Kansas City	78,990	54,295	46,190	46,190
Dallas	39,425	29,425	29,105	22,505
San Francisco	1,339,485	147,805	1,181,035	106,835
Treasury	363,950	363,950	398,255	398,255
TOTALS	$25,665,260	$7,028,365	$23,498,905	$7,017,145
Type				
Competitive	$22,521,620	$3,884,725	$20,120,195	$3,638,435
Noncompetitive	1,154,425	1,154,425	1,016,410	1,016,410
Subtotal, Public	$23,676,045	$5,039,150	$21,136,605	$4,654,845
Federal Reserve	1,781,715	1,781,715	1,700,000	1,700,000
Foreign Official Institutions	207,500	207,500	662,300	662,300
TOTALS	$25,665,260	$7,028,365	$23,498,905	$7,017,145

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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

LIBRARY, ROOM 5310

February 10, 1986

FEB 13 8 21 AM '86

DEPARTMENT OF THE TREASURY

Robert B. Zoellick Appointed
Deputy Assistant Secretary for Financial Institutions Policy

Secretary of the Treasury James A. Baker, III, today announced the appointment of Robert B. Zoellick as Deputy Assistant Secretary for Financial Institutions Policy.

He will be responsible for coordinating the Treasury Department's development of policy and legislation affecting banks, thrifts, and other providers of financial services.

Mr. Zoellick will serve as Deputy to Charles O. Sethness, Assistant Secretary of the Treasury for Domestic Finance, who is coordinating this area and others for George D. Gould, Under Secretary for Finance. Mr. Zoellick also will work closely with representatives of other Federal agencies responsible for the regulation of financial institutions.

Mr. Zoellick had been Special Assistant to Deputy Secretary of the Treasury Richard G. Darman since July, 1985, and had served as acting Deputy Assistant Secretary since December. Prior to joining the Treasury Department, he was Vice President and Assistant to the Chairman and Chief Executive Officer of the Federal National Mortgage Association (Fannie Mae).

Mr. Zoellick received a J.D. magna cum laude and a Master of Public Policy degree from Harvard University. He is a graduate of Swarthmore College.

A native of Illinois, he has practiced law in Washington and has served as clerk to Judge Patricia M. Wald on the U.S. Court of Appeals for the District of Columbia Circuit. Mr. Zoellick also worked in Hong Kong as a recipient of a Luce Foundation Fellowship and served with the Council on Wage and Price Stability from 1975 to 1976.

He and his wife Sherry live in Washington.

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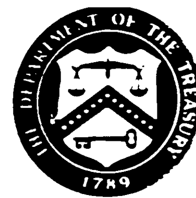
TREASURY NEWS



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

FOR RELEASE AT 4:00 P.M. February 11, 1986

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $13,600 million, to be issued February 20, 1986. This offering will result in a paydown for the Treasury of about $1,100 million, as the maturing bills are outstanding in the amount of $14,704 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Tuesday, February 18, 1986. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,800 million, representing an additional amount of bills dated November 21, 1985, and to mature May 22, 1986 (CUSIP No. 912794 KG 8), currently outstanding in the amount of $7,466 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,800 million, to be dated February 20, 1986, and to mature August 21, 1986 (CUSIP No. 912794 LA 0).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing February 20, 1986. In addition to the maturing 13-week and 26-week bills, there are $8,525 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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 $2,048 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $2,173 million as agents for foreign and international monetary authorities, and $5,670 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE February 13, 1986

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,003 million of 52-week bills to be issued February 20, 1986, and to mature February 19, 1987, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	7.17%	7.69%	92.750
High -	7.20%	7.72%	92.720
Average -	7.19%	7.71%	92.730

Tenders at the high discount rate were allotted 1%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 16,900	$ 16,900
New York	20,483,285	8,091,235
Philadelphia	12,935	12,935
Cleveland	22,935	22,935
Richmond	28,325	28,325
Atlanta	95,490	43,990
Chicago	1,373,395	238,355
St. Louis	76,420	34,470
Minneapolis	39,930	20,130
Kansas City	48,580	46,600
Dallas	19,820	9,870
San Francisco	1,330,985	308,185
Treasury	129,185	129,185
TOTALS	$23,678,185	$9,003,115
Type		
Competitive	$20,723,940	$6,048,870
Noncompetitive	579,245	579,245
Subtotal, Public	$21,303,185	$6,628,115
Federal Reserve	2,250,000	2,250,000
Foreign Official Institutions	125,000	125,000
TOTALS	$23,678,185	$9,003,115

An additional $130,000 thousand of the bills will be issued to foreign official institutions for new cash.

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TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. February 12, 1986

TREASURY TO AUCTION $9,500 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $9,500 million of 2-year notes to refund $8,479 million of 2-year notes maturing February 28, 1986, and to raise about $1,025 million new cash. The $8,479 million of maturing 2-year notes are those held by the public, including $418 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $9,500 million is being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average price of accepted competitive tenders.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $662 million of the maturing securities that may be refunded by issuing additional amounts of the new notes at the average price of accepted competitive tenders.

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

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Attachment

B-467

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED FEBRUARY 28, 1986

February 12, 1986

Amount Offered:

To the public	$9,500 million

Description of Security:

Term and type of security	2-year notes
Series and CUSIP designation	W-1988 (CUSIP No. 912827 TH 5)
Maturity Date	February 29, 1988
Call date	No provision
Interest 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	August 31, 1986; February 28, 1987; August 31, 1987; and February 29, 1988
Minimum denomination available ..	$5,000

Terms of Sale:

Method of sale	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None
Payment by non-institutional investors	Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts ...	Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions	Acceptable

Key Dates:

Receipt of tenders	Wednesday, February 19, 1986, prior to 1:00 p.m., EST
Settlement (final payment due from institutions)	
a) cash or Federal funds	Friday, February 28, 1986
b) readily-collectible check ..	Wednesday, February 26, 1986

federal financing bank
WASHINGTON, D.C. 20220
NEWS
Press 566-2041
FFB 566-2468

LIBRARY, ROOM 5310

FOR IMMEDIATE RELEASE FEB 21 9 49 AM '86
DEPARTMENT OF THE TREASURY February 12, 1986

FEDERAL FINANCING BANK ACTIVITY

Francis X. Cavanaugh, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of December 1985.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $153.4 billion on December 31, 1985, posting a decrease of $0.8 billion from the level on November 30, 1985. Increases of $0.3 billion in holdings of agency debt and of less than $0.1 billion in agency assets partially offset a decrease of $1.1 billion in holdings of agency-guaranteed debt. FFB made 368 disbursements during December.

Attached to this release are tables presenting FFB December loan activity and FFB holdings as of December 31, 1985.

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B-468

FEDERAL FINANCING BANK

DECEMBER 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
EXPORT-IMPORT BANK					
Note #66	12/2	$ 417,000,000.00	12/1/95	9.715%	9.605% qtr.
Note #67	12/2	261,000,000.00	12/1/95	9.368%	9.261% qtr.
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
Note #372	12/2	5,000,000.00	3/3/86	7.565%	
+Note #373	12/9	1,760,000.00	3/10/86	7.615%	
+Note #374	12/9	9,850,000.00	3/10/86	7.615%	
+Note #375	12/16	20,535,000.00	3/17/86	7.325%	
+Note #376	12/30	65,550,000.00	4/1/86	7.315%	
TENNESSEE VALLEY AUTHORITY					
Advance #545	12/2	181,000,000.00	12/9/85	7.515%	
Advance #546	12/5	303,000,000.00	12/12/85	7.585%	
Advance #547	12/9	357,000,000.00	12/16/85	7.605%	
Advance #548	12/12	298,000,000.00	12/18/85	7.395%	
Advance #549	12/16	338,000,000.00	12/23/85	7.325%	
Advance #550	12/18	293,000,000.00	12/26/85	7.355%	
Advance #551	12/23	311,000,000.00	12/31/85	7.395%	
Advance #552	12/26	35,000,000.00	1/1/86	7.405%	
Advance #553	12/26	248,000,000.00	1/2/86	7.405%	
Advance #554	12/30	317,000,000.00	1/6/85	7.305%	
Advance #555	12/31	122,000,000.00	1/8/85	7.405%	
UNITED STATES RAILWAY ADMINISTRATION					
*Note #33	12/31	79,709,034.93	3/31/86	7.295%	
AGENCY ASSETS					
FARMERS HOME ADMINISTRATION					
Certificates of Beneficial Ownership					
	12/1	30,000,000.00	12/1/00	9.965%	10.213% ann.
	12/12	15,000,000.00	12/1/00	9.595%	9.825% ann.
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Philippines 10	12/4	6,140,780.86	7/15/92	9.328%	
Niger 2	12/5	193,810.29	10/15/90	8.425%	
Egypt 6	12/9	442,817.56	4/15/14	10.105%	
Morocco 11	12/9	18,099.74	9/8/95	8.805%	
Ecuador 8	12/10	163,901.00	7/31/96	9.037%	
Egypt 6	12/10	22,499,998.46	4/15/14	9.947%	
Egypt 7	12/10	45,000,001.54	7/31/14	10.074%	
Greece 15	12/10	319,500.00	6/15/12	9.825%	
Turkey 18	12/10	17,176,427.75	3/12/14	9.543%	
Kenya 11	12/11	616,702.23	5/15/95	9.451%	
Greece 14	12/13	175,983.00	4/30/11	9.855%	

+rollover
*maturity extension

FEDERAL FINANCING BANK

DECEMBER 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual	INTEREST RATE (other than semi-annual)
Foreign Military Sales (Cont'd)					
Greece 15	12/13	$ 705,338.72	6/15/12	9.605%	
Indonesia 10	12/13	1,605,429.00	3/20/93	8.835%	
Morocco 13	12/13	61,358.92	5/31/96	9.045%	
Philippines 10	12/13	427,880.00	7/15/92	8.955%	
Tunisia 17	12/13	406,705.80	9/15/96	8.983%	
Portugal 1	12/16	1,461,789.00	9/10/94	8.890%	
Peru 9	12/16	955,667.09	9/15/95	9.164%	
Egypt 7	12/16	1,099,675.86	7/31/14	9.845%	
Turkey 18	12/16	605,278.26	3/12/14	9.265%	
Jordan 12	12/17	1,913,725.00	2/5/95	9.075%	
Colombia 7	12/18	4,550,870.00	9/5/91	7.660%	
Egypt 7	12/18	50,000,000.00	7/31/14	9.654%	
Philippines 10	12/18	365,236.68	7/15/92	8.805%	
Tunisia 17	12/18	20,959.00	9/15/96	8.875%	
Turkey 18	12/18	866,179.97	3/12/14	9.105%	
Jordan 12	12/20	3,289,222.69	2/5/95	9.070%	
Egypt 7	12/24	2,790,244.00	7/31/14	9.665%	
Bolivia 2	12/30	104,168.13	11/22/95	9.075%	
Egypt 6	12/30	188,934.90	4/15/14	9.445%	
Jordan 12	12/30	454,949.84	2/5/95	8.985%	
Morocco 9	12/30	69,580.08	3/31/94	9.015%	
Spain 8	12/30	58,167,277.00	3/25/96	8.338%	
Turkey 18	12/30	199,444.00	3/12/14	9.075%	
Egypt 6	12/31	699,100.55	4/15/14	9.455%	
Turkey 18	12/31	6,560,780.00	3/12/14	9.097%	
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
*Bristol, VA	12/2	359,000.00	12/1/87	8.399%	8.575% ann.
*Hialeah, FL	12/2	548,859.32	12/1/89	8.858%	9.054% ann.
*Hialeah, FL	12/2	146,379.45	12/1/89	9.095%	9.302% ann.
*St. Petersburg, FL	12/2	1,320,000.00	12/3/90	8.960%	9.161% ann.
Indianapolis, IN	12/5	5,677,000.00	3/3/86	7.585%	
Indianapolis, IN	12/5	145,000.00	2/3/86	7.585%	
Janesville, WI	12/5	73,345.00	2/3/86	7.585%	
Newport News, VA	12/5	55,900.00	2/18/86	7.585%	
San Diego, CA	12/12	2,300,000.00	8/1/86	7.565%	7.629% ann.
Santa Ana, CA	12/12	308,000.00	8/15/86	7.575%	7.652% ann.
*Elizabeth, NJ	12/16	531,250.00	12/16/91	8.647%	8.834% ann.
*Yonkers, NY	12/16	2,000,000.00	12/1/90	8.494%	8.674% ann.
Oakland, CA	12/18	200,000.00	9/2/03	9.298%	9.514% ann.
Mayaguez, PR	12/18	12,000.00	8/1/86	7.525%	7.583% ann.
Newport News, VA	12/23	83,200.00	2/18/86	7.395%	
Long Beach, CA	12/31	110,000.00	8/1/86	7.535%	7.581% ann.
Mayaguez, PR	12/31	8,225.00	8/1/86	7.535%	7.581% ann.
Garden Grove, CA	12/31	596,408.00	8/1/86	7.595%	7.640% ann.
Lynn, MA	12/31	137,570.92	8/15/86	7.615%	7.676% ann.
Montgomery County, PA	12/31	925,000.00	5/15/87	7.885%	8.040% ann.
DEPARTMENT OF THE NAVY					
Ship Lease Financing					
+Cobb	12/10	421,650.34	1/15/86	7.555%	
RURAL ELECTRIFICATION ADMINISTRATION					
*Saluda River Electric #186	12/2	1,000,000.00	12/31/15	10.030%	9.907% qtr.
*Saluda River Electric #186	12/2	2,811,000.00	12/31/17	10.026%	9.903% qtr.
Saluda River Electric #271	12/2	778,000.00	1/2/18	10.019%	9.897% qtr.
*Kamo Electric #209	12/2	4,941,000.00	12/2/87	8.595%	8.505% qtr.

+rollover
*maturity extension

FEDERAL FINANCING BANK

DECEMBER 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
*United Power #67	12/2	$ 1,300,000.00	12/2/87	8.595%	8.505% qtr.
*United Power #129	12/2	3,000,000.00	12/2/87	8.595%	8.505% qtr.
*Tri-State G&T #89	12/2	3,625,000.00	12/31/13	10.033%	9.910% qtr.
*Western Farmers Electric #133	12/2	4,250,396.24	12/31/14	10.032%	9.909% qtr.
*Western Farmers Electric #133	12/2	4,000,000.00	12/31/15	10.030%	9.907% qtr.
*S. Mississippi Electric #171	12/2	3,500,000.00	12/31/15	10.030%	9.907% qtr.
*Corn Belt Power #55	12/2	125,000.00	12/2/87	8.595%	8.505% qtr.
*Corn Belt Power #138	12/2	162,000.00	12/2/87	8.595%	8.505% qtr.
*Seminole Electric #141	12/2	36,562,000.00	12/2/87	8.595%	8.505% qtr.
*Dairyland Power #54	12/2	1,187,000.00	12/31/13	10.034%	9.911% qtr.
*East Kentucky Power #188	12/5	4,000,000.00	1/3/17	10.051%	9.928% qtr.
*East Kentucky Power #188	12/5	7,000,000.00	1/3/17	10.051%	9.928% qtr.
*Seminole Electric #141	12/5	8,765,000.00	12/5/88	8.875%	8.799% qtr.
*Glacier State Telephone #181	12/5	2,424,000.00	12/31/15	10.055%	9.932% qtr.
*East Kentucky Power #140	12/6	9,480,000.00	12/31/13	10.065%	9.941% qtr.
*Tex-La Electric #208	12/6	600,000.00	12/31/17	10.053%	9.930% qtr.
*Colorado Ute Electric #152	12/9	1,045,000.00	12/9/87	8.595%	8.505% qtr.
*Upper Missouri G&T #172	12/9	345,000.00	12/9/87	8.595%	8.505% qtr.
*Wolverine Power #190	12/9	148,000.00	12/7/88	8.875%	8.779% qtr.
Central Iowa Power #184	12/10	2,818,658.00	12/31/19	9.928%	9.808% qtr.
*Wolverine Power #100	12/12	1,079,000.00	12/31/87	8.138%	8.057% qtr.
*Wolverine Power #101	12/12	1,303,000.00	12/31/87	8.138%	8.057% qtr.
*Wolverine Power #101	12/12	220,000.00	12/31/87	8.138%	8.057% qtr.
*Wolverine Power #182	12/12	2,958,000.00	12/9/88	8.405%	8.319% qtr.
*Wolverine Power #183	12/12	3,713,000.00	12/9/88	8.405%	8.319% qtr.
*Wabash Valley Power #104	12/12	5,302,000.00	12/12/87	8.125%	8.044% qtr.
*Wabash Valley Power #206	12/12	8,313,000.00	12/12/87	8.125%	8.044% qtr.
*Tri-State G&T #79	12/13	1,490,000.00	12/31/12	9.744%	9.628% qtr.
*Central Electric #131	12/16	177,000.00	12/31/13	9.685%	9.571% qtr.
*Soyland Power #165	12/16	9,201,000.00	12/31/15	9.685%	9.571% qtr.
*Western Illinois Power #162	12/16	3,535,000.00	12/31/15	9.685%	9.571% qtr.
*Cont. Tel. of Kentucky #115	12/16	100,000.00	12/16/87	8.095%	8.015% qtr.
*Cont. Tel. of Kentucky #254	12/16	2,400,000.00	12/16/87	8.095%	8.015% qtr.
*Colorado Ute Electric #203	12/16	993,000.00	12/16/87	8.095%	8.015% qtr.
*New Hampshire Electric #192	12/16	1,170,000.00	12/31/17	9.685%	9.571% qtr.
Corn Belt Power #292	12/16	394,000.00	12/31/87	8.105%	8.025% qtr.
Associated Electric #132	12/16	19,000,000.00	12/31/19	9.684%	9.570% qtr.
Deseret G&T #211	12/16	23,372,000.00	12/16/87	8.095%	8.015% qtr.
Vermont Electric #259	12/16	518,000.00	12/31/19	9.684%	9.570% qtr.
Cont. Tel. of Arkansas #264	12/17	380,000.00	1/2/90	8.655%	8.563% qtr.
Cont. Tel. of Arkansas #265	12/17	773,000.00	1/2/90	8.655%	8.563% qtr.
Cont. Tel. of Missouri #253	12/17	2,132,000.00	1/2/90	8.655%	8.563% qtr.
Hoosier Energy #202	12/17	6,171,000.00	12/31/19	9.608%	9.495% qtr.
*Seminole Electric #141	12/18	8,510,000.00	12/31/15	9.505%	9.395% qtr.
*Seminole Electric #141	12/18	16,167,000.00	12/31/16	9.504%	9.394% qtr.
Cont. Tel. of Iowa #258	12/18	742,000.00	1/2/90	8.515%	8.426% qtr.
Oglethorpe Power #246	12/19	61,013,000.00	12/21/87	8.165%	8.083% qtr.
*Colorado Ute Electric #96	12/19	3,720,000.00	12/19/87	8.165%	8.083% qtr.
*Hoosier Energy #107	12/19	25,048,205.92	12/31/14	9.567%	9.455% qtr.
*Cajun Electric #76	12/19	20,000,000.00	12/31/15	9.565%	9.453% qtr.
*Cajun Electric #197	12/19	10,000,000.00	12/31/15	9.565%	9.453% qtr.
*Oglethorpe Power #150	12/19	10,031,036.00	12/31/15	9.565%	9.453% qtr.
*N.E. Missouri Electric #217	12/19	1,760,000.00	12/31/17	9.562%	9.450% qtr.
*Old Dominion Electric #267	12/19	2,006,000.00	12/31/13	9.496%	9.386% qtr.
*Seminole Electric #141	12/20	11,874,000.00	1/3/17	9.546%	9.435% qtr.
*Seminole Electric #141	12/20	12,000,000.00	12/31/18	9.541%	9.430% qtr.
*Tri-State G&T #79	12/10	425,000.00	12/31/14	9.556%	9.445% qtr.
*Tri-State G&T #89	12/20	6,144,000.00	12/31/13	9.557%	9.445% qtr.
*Tri-State G&T #89	12/20	1,355,000.00	12/31/13	9.557%	9.445% qtr.
*Tri-State G&T #89	12/20	3,619,000.00	12/31/13	9.557%	9.445% qtr.
*Tri-State G&T #89	12/20	2,301,000.00	12/31/13	9.557%	9.445% qtr.
*Tri-State G&T #89	12/20	8,965,000.00	12/31/13	9.557%	9.445% qtr.

*maturity extension

FEDERAL FINANCING BANK

DECEMBER 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
*Tri-State G&T #89	12/20	$ 10,413,000.00	12/31/13	9.557%	9.445% qtr.
*Tri-State G&T #89	12/20	3,648,000.00	12/31/13	9.557%	9.445% qtr.
*Tri-State G&T #89	12/20	2,763,000.00	12/31/13	9.557%	9.445% qtr.
*Tri-State G&T #89	12/20	2,702,000.00	12/31/13	9.557%	9.445% qtr.
*Tri-State G&T #157	12/20	1,250,000.00	12/31/15	9.553%	9.442% qtr.
*Tri-State G&T #157	12/20	1,185,000.00	12/31/15	9.553%	9.442% qtr.
*Tri-State G&T #157	12/20	500,000.00	12/31/15	9.553%	9.442% qtr.
*Tri-State G&T #157	12/20	395,000.00	1/3/17	9.547%	9.436% qtr.
*Tri-State G&T #157	12/20	1,200,000.00	1/3/17	9.547%	9.436% qtr.
*Tri-State G&T #157	12/20	1,623,000.00	1/3/17	9.548%	9.437% qtr.
*Tri-State G&T #177	12/20	227,040.00	12/31/15	9.552%	9.441% qtr.
*Tri-State G&T #177	12/20	11,172,000.00	12/31/15	9.552%	9.441% qtr.
*Tri-State G&T #199	12/20	2,242,000.00	12/31/15	9.553%	9.442% qtr.
*Tri-State G&T #199	12/20	820,000.00	1/3/17	9.547%	9.436% qtr.
*East Kentucky Power #140	12/23	560,000.00	1/3/17	9.496%	9.386% qtr.
*East Kentucky Power #140	12/23	300,000.00	1/3/17	9.496%	9.386% qtr.
*East Kentucky Power #188	12/23	16,500,000.00	12/31/18	9.493%	9.383% qtr.
*East Kentucky Power #73	12/23	3,165,291.00	12/31/15	9.495%	9.385% qtr.
*Dairyland Power #161	12/23	2,418,000.00	12/23/87	8.135%	8.054% qtr.
*Wabash Valley Power #206	12/23	748,000.00	12/23/87	8.135%	8.054% qtr.
*Wabash Valley Power #252	12/23	350,000.00	12/23/87	8.135%	8.054% qtr.
*Central Electric #131	12/23	140,000.00	12/31/15	9.499%	9.389% qtr.
*Brazos Electric #108	12/23	1,931,000.00	12/31/15	9.499%	9.389% qtr.
*Brazos Electric #144	12/23	3,824,000.00	12/31/15	9.499%	9.389% qtr.
*Oglethorpe Power #246	12/23	952,288.00	12/31/17	9.496%	9.386% qtr.
Cajun Electric #263	12/26	45,920,000.00	12/31/87	8.154%	8.073% qtr.
*Plains Electric #158	12/26	10,172,000.00	12/31/16	9.505%	9.395% qtr.
*Plains Electric #158	12/26	7,336,000.00	12/31/16	9.505%	9.395% qtr.
*Plains Electric #158	12/26	7,464,000.00	12/31/16	9.505%	9.395% qtr.
*Soyland Power #105	12/26	7,248,000.00	12/31/12	9.518%	9.407% qtr.
*Soyland Power #105	12/27	9,243,000.00	12/31/13	9.491%	9.381% qtr.
Wolverine Power #274	12/27	683,000.00	12/31/87	8.119%	8.038% qtr.
North Carolina Electric #268	12/27	17,942,000.00	1/2/18	9.487%	9.377% qtr.
*Colorado Ute Electric #152	12/30	22,335,000.00	12/30/87	8.115%	8.034% qtr.
*Colorado Ute Electric #168	12/30	418,323.00	12/30/87	8.115%	8.034% qtr.
*Colorado Ute Electric #198	12/30	2,690,000.00	12/30/87	8.115%	8.034% qtr.
*Colorado Ute Electric #198	12/30	8,565,000.00	12/30/87	8.115%	8.034% qtr.
*New Hampshire Electric #192	12/30	2,067,500.00	1/2/18	9.445%	9.336% qtr.
*Glacier State Telephone #181	12/30	3,000,000.00	1/2/18	9.445%	9.336% qtr.
*Saluda River Electric #186	12/30	11,760,000.00	1/2/18	9.445%	9.336% qtr.
*East River Electric #117	12/30	1,250,000.00	12/29/88	8.365%	8.279% qtr.
*Corn Belt Power #138	12/30	117,000.00	12/30/87	8.115%	8.034% qtr.
*Basin Electric #232	12/30	570,000.00	12/30/87	8.115%	8.034% qtr.
*Tex-La Electric #208	12/30	3,408,000.00	12/31/17	9.445%	9.336% qtr.
*West Virginia Telephone #17	12/30	718,000.00	12/30/87	8.115%	8.034% qtr.
*Seminole Electric #141	12/30	21,106,000.00	12/30/87	8.115%	8.034% qtr.
*Vermont Electric #193	12/30	1,800,000.00	12/31/17	9.445%	9.336% qtr.
Cajun Electric #249	12/30	5,000,000.00	12/31/19	9.440%	9.331% qtr.
Saluda River Electric #271	12/30	11,166,000.00	1/2/18	9.439%	9.330% qtr.
Brazos Electric #230	12/30	625,000.00	12/31/19	9.440%	9.331% qtr.
*North Carolina Electric #185	12/31	5,122,000.00	12/31/15	9.466%	9.357% qtr.
*North Carolina Electric #185	12/31	3,004,000.00	12/31/15	9.466%	9.357% qtr.
*North Carolina Electric #185	12/31	25,505,000.00	12/31/15	9.466%	9.357% qtr.
*North Carolina Electric #185	12/31	8,258,000.00	12/31/17	9.458%	9.349% qtr.
*North Carolina Electric #185	12/31	7,299,000.00	12/31/17	9.458%	9.349% qtr.
*North Carolina Electric #185	12/31	38,062,000.00	12/31/17	9.458%	9.349% qtr.
*Ogden Telephone #72	12/31	750,000.00	12/31/13	9.473%	9.363% qtr.
*Colorado Ute Electric #78	12/31	3,784,666.64	12/31/87	8.115%	8.034% qtr.
*Cajun Electric #263	12/31	62,000,000.00	12/31/87	8.123%	8.042% qtr.
*Cajun Electric #263	12/31	32,680,000.00	12/31/87	8.123%	8.042% qtr.
*Kansas Electric #216	12/31	907,000.00	12/31/87	8.125%	8.044% qtr.
*Kansas Electric #216	12/31	1,140,000.00	12/31/87	8.125%	8.044% qtr.

*maturity extension

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BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
*Kansas Electric #216	12/31	$ 825,000.00	12/31/87	8.125%	8.044% qtr.
*Kansas Electric #216	12/31	575,000.00	12/31/87	8.125%	8.044% qtr.
*Kansas Electric #216	12/31	1,065,000.00	12/31/87	8.125%	8.044% qtr.
*Kansas Electric #216	12/31	1,245,000.00	12/31/87	8.125%	8.044% qtr.
Tex-La Electric #208	12/31	5,297,000.00	12/31/19	9.453%	9.344% qtr.
New Hampshire Electric #270	12/31	3,023,000.00	12/31/17	9.465%	9.356% qtr.
Kamo Electric #209	12/31	1,798,000.00	12/31/19	9.453%	9.344% qtr.
*Vermont Electric #193	12/31	158,000.00	12/31/15	9.466%	9.357% qtr.
*Vermont Electric #259	12/31	1,700,000.00	1/2/18	9.458%	9.349% qtr.
*Vermont Electric #259	12/31	1,500,000.00	1/2/18	9.458%	9.349% qtr.
*Cont. Tel. of Kansas #201	12/31	4,020,000.00	1/3/89	8.375%	8.289% qtr.
*Old Dominion Electric #267	12/31	48,232,323.25	12/31/13	9.402%	9.294% qtr.
*Old Dominion Electric #267	12/31	48,232,323.25	12/31/13	9.402%	9.294% qtr.
*Old Dominion Electric #267	12/31	48,232,323.25	12/31/87	8.119%	8.038% qtr.
*Old Dominion Electric #267	12/31	45,731,959.62	12/31/87	8.119%	8.038% qtr.
*Tri-State G&T #79	12/31	2,504,000.00	12/31/13	9.472%	9.362% qtr.
*Tri-State G&T #79	12/31	2,399,000.00	12/31/13	9.472%	9.362% qtr.
*Tri-State G&T #79	12/31	1,726,000.00	12/31/13	9.472%	9.362% qtr.
*Tri-State G&T #89	12/31	4,999,680.00	12/31/87	8.119%	8.038% qtr.
*Tri-State G&T #89	12/31	24,184,320.00	12/31/87	8.119%	8.038% qtr.
*Tri-State G&T #89	12/31	6,296,000.00	12/31/87	8.119%	8.038% qtr.
*Tri-State G&T #89	12/31	5,164,000.00	12/31/87	8.119%	8.038% qtr.
*S. Mississippi Electric #3	12/31	4,986,111.12	1/3/11	9.329%	9.223% qtr.
*S. Mississippi Electric #3	12/31	4,521,296.32	1/3/11	9.329%	9.223% qtr.
*S. Mississippi Electric #3	12/31	1,764,814.80	1/3/11	9.329%	9.223% qtr.
*East Kentucky Power #73	12/31	6,116,478.28	12/31/15	9.461%	9.352% qtr.
*Kamo Electric #266	12/31	68,445,000.00	12/31/15	9.461%	9.352% qtr.
*Allegheny Electric #255	12/31	20,000,000.00	1/2/18	9.458%	9.349% qtr.
*Big Rivers Electric #58	12/31	1,590,000.00	12/31/13	9.473%	9.363% qtr.
*Big Rivers Electric #58	12/31	519,000.00	12/31/13	9.473%	9.363% qtr.
*Big Rivers Electric #91	12/31	2,230,000.00	12/31/13	9.473%	9.363% qtr.
*Big Rivers Electric #91	12/31	5,423,000.00	12/31/13	9.473%	9.363% qtr.
*Big Rivers Electric #91	12/31	416,000.00	12/31/15	9.466%	9.357% qtr.
*Big Rivers Electric #91	12/31	258,000.00	12/31/15	9.466%	9.357% qtr.
*Big Rivers Electric #136	12/31	483,000.00	12/31/13	9.473%	9.363% qtr.
*Big Rivers Electric #136	12/31	699,000.00	12/31/13	9.473%	9.363% qtr.
*Big Rivers Electric #136	12/31	73,000.00	12/31/15	9.466%	9.357% qtr.
*Big Rivers Electric #136	12/31	15,000.00	12/31/15	9.466%	9.357% qtr.
*Big Rivers Electric #136	12/31	155,000.00	1/2/18	9.458%	9.349% qtr.
*Big Rivers Electric #143	12/31	47,000.00	12/31/15	9.466%	9.357% qtr.
*Big Rivers Electric #143	12/31	60,000.00	12/31/15	9.466%	9.357% qtr.
*Big Rivers Electric #143	12/31	45,000.00	12/31/18	9.458%	9.349% qtr.
*Big Rivers Electric #143	12/31	94,000.00	12/31/18	9.458%	9.349% qtr.
*Big Rivers Electric #179	12/31	19,939,000.00	12/31/15	9.466%	9.357% qtr.
*Big Rivers Electric #179	12/31	5,770,000.00	12/31/18	9.458%	9.349% qtr.
*Big Rivers Electric #179	12/31	2,695,000.00	12/31/18	9.458%	9.349% qtr.
*Sunflower Electric #174	12/31	15,000,000.00	12/31/87	8.125%	8.044% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
Caprock Local Dev. Company	12/4	58,000.00	12/1/00	9.804%	
Riverside Development Corp.	12/4	63,000.00	12/1/00	9.804%	
Jackson Local Development Co.	12/4	74,000.00	12/1/00	9.804%	
Hamilton County Dev. Co.	12/4	99,000.00	12/1/00	9.804%	
Enterprise Dev. Corp.	12/4	109,000.00	12/1/00	9.804%	
Empire St. Cert. Dev. Corp.	12/4	111,000.00	12/1/00	9.804%	
Wisconsin Bus. Dev. Fin. Corp.	12/4	137,000.00	12/1/00	9.804%	
Saint Paul 503 Dev. Co.	12/4	189,000.00	12/1/00	9.804%	
Ohio Statewide Dev. Corp.	12/4	221,000.00	12/1/00	9.804%	
Montgomery County Bus. D.C.	12/4	273,000.00	12/1/00	9.804%	
Nine County Dev., Inc.	12/4	283,000.00	12/1/00	9.804%	
Milwaukee Econ. Dev. Corp.	12/4	294,000.00	12/1/00	9.804%	

*maturity extension

FEDERAL FINANCING BANK

DECEMBER 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
State & Local Development Company Debentures (Cont'd)					
St. Louis County LDC	12/4	$ 413,000.00	12/1/00	9.804%	
Wisconsin Bus. Dev. Fin. Corp.	12/4	498,000.00	12/1/00	9.804%	
Gr. Salt Lake Business Dist.	12/4	500,000.00	12/1/00	9.804%	
Bay Colony Dev. Corp.	12/4	500,000.00	12/1/00	9.804%	
Nine County Dev., Inc.	12/4	15,000.00	12/1/05	10.023%	
Nine County Dev., Inc.	12/4	16,000.00	12/1/05	10.023%	
Nine County Dev., Inc.	12/4	24,000.00	12/1/05	10.023%	
Mo-Kan Dev., Inc.	12/4	32,000.00	12/1/05	10.023%	
Coastal Area D.D.A., Inc.	12/4	38,000.00	12/1/05	10.023%	
Rural Missouri, Inc.	12/4	47,000.00	12/1/05	10.023%	
St. Louis Local Dev. Co.	12/4	65,000.00	12/1/05	10.023%	
E.C.I.A. Bus. Growth, Inc.	12/4	66,000.00	12/1/05	10.023%	
Texas Cert. Dev. Co., Inc.	12/4	77,000.00	12/1/05	10.023%	
Hamilton County Dev. Corp.	12/4	84,000.00	12/1/05	10.023%	
HEDCO Local Dev. Corp.	12/4	89,000.00	12/1/05	10.023%	
Old Colorado City Dev. Co.	12/4	91,000.00	12/1/05	10.023%	
Crossroads EDC of St. Charles	12/4	93,000.00	12/1/05	10.023%	
Gr. Salt Lake Business Dist.	12/4	111,000.00	12/1/05	10.023%	
Enterprise Development Corp.	12/4	115,000.00	12/1/05	10.023%	
Columbus Countywide Dev. Corp.	12/4	117,000.00	12/1/05	10.023%	
Wilmington Indus. Dev., Inc.	12/4	118,000.00	12/1/05	10.023%	
ARK-TEX Reg. Dev. Co., Inc.	12/4	118,000.00	12/1/05	10.023%	
Gr. Salt Lake Business Dist.	12/4	125,000.00	12/1/05	10.023%	
Gr. Salt Lake Business Dist.	12/4	125,000.00	12/1/05	10.023%	
Androscoggin Valley C.G.	12/4	130,000.00	12/1/05	10.023%	
Long Island Dev. Corp.	12/4	133,000.00	12/1/05	10.023%	
San Diego County L.D.C.	12/4	137,000.00	12/1/05	10.023%	
Commonwealth Small Bus. D.C.	12/4	147,000.00	12/1/05	10.023%	
Cen. Calif. Cert. Dev. Corp.	12/4	157,000.00	12/1/05	10.023%	
Econ. Dev. Fnd. of Sacramento	12/4	168,000.00	12/1/05	10.023%	
Coastal Area Dis. Dev. Auth.	12/4	175,000.00	12/1/05	10.023%	
Long Island Dev. Corp.	12/4	187,000.00	12/1/05	10.023%	
Bay Colony Dev. Corp.	12/4	189,000.00	12/1/05	10.023%	
Altoona Enterprises, Inc.	12/4	193,000.00	12/1/05	10.023%	
Long Island Dev. Corp.	12/4	200,000.00	12/1/05	10.023%	
Southern Nevada Cert. Dev. Co.	12/4	207,000.00	12/1/05	10.023%	
Downtown Improvement Corp.	12/4	231,000.00	12/1/05	10.023%	
Mid-Atlantic Cert. Dev. Co.	12/4	231,000.00	12/1/05	10.023%	
Clay County Dev. Corp.	12/4	237,000.00	12/1/05	10.023%	
Maine Dev. Foundation	12/4	252,000.00	12/1/05	10.023%	
Gr. Pocatello Dev. Corp.	12/4	257,000.00	12/1/05	10.023%	
San Diego County L.D.C.	12/4	259,000.00	12/1/05	10.023%	
Long Island Dev. Corp.	12/4	280,000.00	12/1/05	10.023%	
Long Island Dev. Corp.	12/4	300,000.00	12/1/05	10.023%	
Rural Missouri, Inc.	12/4	302,000.00	12/1/05	10.023%	
Enterprise Dev. Corp.	12/4	304,000.00	12/1/05	10.023%	
Three Rivers L.D.C., Inc.	12/4	315,000.00	12/1/05	10.023%	
West Virginia C.D.C.	12/4	318,000.00	12/1/05	10.023%	
Franklin County Indus. Dev. Co.	12/4	335,000.00	12/1/05	10.023%	
Gr. Spokane Bus. Dev. Assoc.	12/4	355,000.00	12/1/05	10.023%	
Gr. Metro. Chicago Dev. Corp.	12/4	380,000.00	12/1/05	10.023%	
Crossroads Ec. Dev. Corp.	12/4	394,000.00	12/1/05	10.023%	
Enterprise Dev. Corp.	12/4	401,000.00	12/1/05	10.023%	
Downtown Improvement Corp.	12/4	451,000.00	12/1/05	10.023%	
Cen. Upper Peninsula BDC, Inc.	12/4	463,000.00	12/1/05	10.023%	
Bay Colony Dev. Corp.	12/4	491,000.00	12/1/05	10.023%	
La Habra L.D.C., Inc.	12/4	500,000.00	12/1/05	10.023%	
HEDCO L.D.C.	12/4	500,000.00	12/1/05	10.023%	
Mid-Atlantic C.D.C.	12/4	500,000.00	12/1/05	10.023%	
Big Country Dev. Corp.	12/4	500,000.00	12/1/05	10.023%	
Empire State C.D.C.	12/4	500,000.00	12/1/05	10.023%	
Mass. C.D.C.	12/4	500,000.00	12/1/05	10.023%	
Central Ozarks Dev., Inc.	12/4	42,000.00	12/1/10	10.123%	
Columbus Countywide Dev. Corp.	12/4	45,000.00	12/1/10	10.123%	

FEDERAL FINANCING BANK

DECEMBER 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
State & Local Development Company Debentures (Cont'd)					
Mentor Economic Asst. Corp.	12/4	$ 63,000.00	12/1/10	10.123%	
St. Louis County L.D.C.	12/4	82,000.00	12/1/10	10.123%	
Long Beach L.D.C.	12/4	84,000.00	12/1/10	10.123%	
Union County Ec. Dev. Corp.	12/4	88,000.00	12/1/10	10.123%	
Region Nine Dev. Corp.	12/4	98,000.00	12/1/10	10.123%	
St. Paul 503 Dev. Co.	12/4	109,000.00	12/1/10	10.123%	
Columbus Countywide Dev. Corp.	12/4	112,000.00	12/1/10	10.123%	
Warren Redev. & Planning Corp.	12/4	135,000.00	12/1/10	10.123%	
Northern VA L.D.C., Inc.	12/4	137,000.00	12/1/10	10.123%	
Mentor Ec. Asst. Corp.	12/4	137,000.00	12/1/10	10.123%	
Neuse River Dev. Auth., Inc.	12/4	141,000.00	12/1/10	10.123%	
Texas C.D.C., Inc.	12/4	146,000.00	12/1/10	10.123%	
Charlotte C.D.C.	12/4	152,000.00	12/1/10	10.123%	
San Diego County L.D.C.	12/4	162,000.00	12/1/10	10.123%	
Six Rivers L.D.C.	12/4	183,000.00	12/1/10	10.123%	
Warren Redev. & Planning Corp.	12/4	184,000.00	12/1/10	10.123%	
Black Hawk County E.D.C., Inc.	12/4	189,000.00	12/1/10	10.123%	
Bay Area Bus. Dev. Co.	12/4	263,000.00	12/1/10	10.123%	
Commercial Indus. Dev. Corp.	12/4	281,000.00	12/1/10	10.123%	
East-Central Idaho Dev. Co.	12/4	283,000.00	12/1/10	10.123%	
E.D.F. of Sacramento, Inc.	12/4	315,000.00	12/1/10	10.123%	
La Habra L.D.C., Inc.	12/4	317,000.00	12/1/10	10.123%	
Warren Redev. & Planning Corp.	12/4	329,000.00	12/1/10	10.123%	
E.D.F. of Sacramento, Inc.	12/4	358,000.00	12/1/10	10.123%	
St. Louis County L.D.C.	12/4	359,000.00	12/1/10	10.123%	
Bay Area Employment Dev. Co.	12/4	380,000.00	12/1/10	10.123%	
Northern VA L.D.C., Inc.	12/4	499,000.00	12/1/10	10.123%	
Massachusetts C.D.C.	12/4	500,000.00	12/1/10	10.123%	
Oshkosh Commercial Dev. Corp.	12/4	500,000.00	12/1/10	10.123%	
Small Business Investment Company Debentures					
New West Partners	12/11	800,000.00	12/1/90	9.105%	
Rocky Mountain Ventures, Ltd.	12/11	750,000.00	12/1/90	9.105%	
Dixie Business Inv. Co, Inc.	12/11	100,000.00	12/1/92	9.465%	
Sunwestern Capital Corp.	12/11	1,000,000.00	12/1/92	9.465%	
Market Capital Corporation	12/11	500,000.00	12/1/95	9.615%	
Walden Capital Partners	12/11	600,000.00	12/1/95	9.615%	
Edwards Capital Corporation	12/11	600,000.00	12/1/95	9.615%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
+Note A-86-03	12/31	620,135,654.23	3/31/86	7.315%	
DEPARTMENT OF TRANSPORTATION					
Section 511—4R Act					
MKT Railroad	12/2	800,000.00	9/14/99	9.236%	

+rollover

FEDERAL FINANCING BANK
DECEMBER 1985 Commitments

BORROWER	GUARANTOR	AMOUNT	COMMITMENT EXPIRES	MATURITY
Harrisburg, PA	HUD	$ 1,474,951.00	12/1/87	12/1/87
Harrisburg, PA	HUD	830,100.00	12/1/86	12/1/92
Kansas City, MO	HUD	1,000,000.00	6/15/86	6/15/86
Lincoln, NE	HUD	446,000.00	11/1/86	11/1/86
Massillon, OH	HUD	800,000.00	9/15/86	9/15/86
Mayaguez, PR	HUD	23,298.18	8/1/86	8/1/86
Sacramento, CA	HUD	1,000,000.00	3/1/88	3/1/88
San Diego, CA	HUD	3,977,900.00	8/1/86	8/1/86

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	December 31, 1985	November 30, 1985	Net Change 12/1/85-12/31/85	Net Change--FY 1986 10/1/85-12/31/85
Agency Debt				
Export-Import Bank	$ 15,670.3	$ 15,409.0	$ 261.3	$ 261.3
NCUA-Central Liquidity Facility	223.2	219.6	3.5	1.0
Tennessee Valley Authority	14,622.0	14,610.0	12.0	241.0
U.S. Postal Service	1,690.0	1,690.0	-0-	-0-
U.S. Railway Association	73.8	73.8	-0-	-0-
Agency Assets				
Farmers Home Administration	64,234.0	64,189.0	45.0	65.0
DHHS-Health Maintenance Org.	105.9	105.9	-0-	-3.3
DHHS-Medical Facilities	122.8	122.8	-0-	-0-
Overseas Private Investment Corp.	4.0	6.1	-2.2	-2.2
Rural Electrification Admin.-CBO	3,724.3	3,724.3	-0-	-0-
Small Business Administration	31.2	31.8	-0.6	-1.7
Government-Guaranteed Lending				
DOD-Foreign Military Sales	18,306.3	18,134.7	171.6	217.8
DEd.-Student Loan Marketing Assn.	5,000.0	5,000.0	-0-	-0-
DHUD-Community Dev. Block Grant	275.4	303.1	-27.7	-14.0
DHUD-New Communities	33.5	33.5	-0-	-0-
DHUD-Public Housing Notes	2,111.4	2,111.4	-0-	-34.7
General Services Administration	405.3	407.4	-2.1	-3.1
DOI-Guam Power Authority	35.1	35.1	-0-	-0-
DOI-Virgin Islands	28.2	28.2	-0-	-0-
NASA-Space Communications Co.	887.6	887.6	-0-	-0-
DON-Ship Lease Financing	1,431.0	1,452.6	-21.6	118.0
DON-Defense Production Act	6.6	6.6	-0-	0.8
Oregon Veteran's Housing	60.0	60.0	-0-	-0-
Rural Electrification Admin.	20,653.8	21,826.0	-1,172.2	-1,021.7
SBA-Small Business Investment Cos.	1,041.9	1,043.6	-1.7	18.0
SBA-State/Local Development Cos.	656.5	635.0	21.5	60.9
TVA-Seven States Energy Corp.	1,696.4	1,670.5	25.9	45.0
DOT-Section 511	65.7	150.0	-84.3	-87.9
DOT-WMATA	177.0	177.0	-0-	-0-
TOTALS*	$ 153,373.2	$ 154,144.9	$ -771.7	$ -140.0

*figures may not total due to rounding

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
February 14, 1986

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TREASURY ANNOUNCES PENALTIES AGAINST TEXAS COMMERCE BANCSHARES

The Department of the Treasury today announced that Texas Commerce Bancshares, Inc. (TCB), a bank holding company with headquarters in Houston, Texas, has agreed on behalf of its bank subsidiaries to pay civil penalties of $1.9 million for violations of the Bank Secrecy Act. The violations consist of failures to file Currency Transaction Reports for cash transactions exceeding $10,000, as required under the Act. These violations include failures to report both international and domestic currency transactions. This represents a complete settlement of TCB's civil liability under the Act.

In the wake of the publicity surrounding the Bank of Boston case, TCB undertook an extensive review of the past Bank Secrecy Act compliance by its 70 banks. TCB then brought the results of the review to Treasury's attention and cooperated fully in developing the scope of its liability.

The penalty was announced by Francis A. Keating, II, Assistant Secretary for Enforcement and Operations. Mr. Keating stated: "In assessing this penalty Treasury considered TCB's commitment to full future compliance and record of past cooperation with Federal law enforcement officials."

The penalty was based on over 7,000 violations by TCB banks. Based on the compliance review done by TCB, examinations by the Comptroller of the Currency and a review of the TCB banks' compliance history, Treasury is confident that the penalty amount is appropriate. TCB has agreed to conduct a further review of cash transactions and to late-file additional Currency Transaction Reports as required by Treasury. Treasury has no information that the bank engaged in criminal activity in connection with these violations.

Mr. Keating added, "We view all Bank Secrecy Act violations as serious given their potential detriment to law enforcement. I am firmly committed to rigorous enforcement of the Bank Secrecy Act, including imposition of civil penalties where appropriate. We believe that Treasury's imposition of civil penalties has contributed substantially to recent increased attention to compliance by many financial institutions. Full compliance with the Bank Secrecy Act is essential to effective law enforcement and a prime law enforcement goal of the Department of the Treasury."

In the last year, over sixty banks have come forward to Treasury to discuss past Bank Secrecy Act non-compliance. Since June 1985, twelve other banks have been penalized in amounts ranging from $121,000 to $4.75 million. The cases of the remaining banks are under review.

TREASURY NEWS

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DEPARTMENT OF THE TREASURY

For Release Upon Delivery
Expected at 2:00 P.M.
February 18, 1986

Testimony of The Honorable James A. Baker, III
Secretary of the Treasury
Before the
Senate Budget Committee
February 18, 1986

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the state of the economy and the new budgetary path. The major economic objectives of the Administration have been described by President Reagan in his State of the Union Message. Further details on this year's economic and budgetary outlook have been provided in the President's Budget and Economic Report. My remarks are an overview of the current situation.

We seek to build on the foundation of the solid economic performance that has already taken place. The current economic expansion has now moved into its fourth year and shows few signs of slackening. Growth was relatively slow at some times during 1985, but by year-end the economy was gaining momentum.

Some favorable features of last year's economic performance deserve at least passing mention.

- Consumer price inflation at 3.8 percent remained in the 3.8 to 4 percent range for the fourth year in a row. A table attached to my prepared statement shows the steady progress that has been made since 1980 when all of the measures of price performance were rising in the double-digit range.

- o Employment has risen strongly in the current expansion, by over 9-1/2 million people. The unemployment rate has been reduced to below 7 percent and further progress is expected. The U.S. economy continues to display great job-creating ability.

- o Last year's financial market performance was also encouraging. Record amounts of credit flowed to private borrowers, despite the persistence of large Federal budget deficits. Short-term interest rates are down on average by about 1/2 percentage point in the past year while many of the long-term rates are down by about two percentage points. The prime rate is down to 9-1/2 percent, the lowest rate in 7 years. Ideally, we would like to have seen interest rates come down even further than they have.

All of this added up to a year of solid economic performance in 1985. The latest economic information is generally favorable. Employment rose sharply in January and the unemployment rate fell. Other statistics have not been quite as strong but the year is off to a good start. The stage has been set for sustained expansion in output, jobs and income.

Sustained economic expansion is one of the most important prerequisites for improving the budget picture, as well as the financial security of the American people. During the current expansion, strong economic growth has been achieved in a much less inflationary environment than in the late 1970's. We must strive to extend that good record into the future.

The Administration forecast calls for 4 percent real growth during the four quarters of 1986. This would seem to be a reasonable expectation. The consensus private forecast has been a little lower, around 3 percent. But the recent economic numbers are causing some upward adjustment in the private forecasts. Those of us who advise the President on these matters feel that the current Administration projections are inherently reasonable although we also recognize that economic forecasting is at best an uncertain art.

The inflation outlook is also relatively promising, although the fall in the external value of the dollar will eventually begin to exert a little upward pressure.

The Federal Reserve obviously needs to remain alert to the needs of both the domestic and international financial situations. While they never lack for critics and there is always room for disagreement on the wisdom of some of their specific actions, it seems to me that the Federal Reserve has been doing a good job recently.

* * *

I would like to turn briefly now to the influence of the international economy on our own economic and fiscal situation. As a result of intensified efforts at promoting a favorable convergence of economic performance among the major industrial countries we have seen some improvement in the world economy. We expect to build on the progress this year. On balance, we expect stronger European and LDC domestic demand growth this year as they continue the process of shifting from export-led to domestic-led growth. Unfortunately there may be some weakening in Japanese growth as the previous stimulus from the trade sector is sharply reduced.

Exchange markets have recognized these generally favorable developments. The decline of the dollar since its peak last winter has been substantial. The yen is at a seven-year high against the dollar. Well over half of the dollar's rise on a real trade-weighted basis against other industrial countries from the end of 1980 to last winter's peaks has been reversed. This is good news for U.S. industry and agriculture. The U.S. trade deficit is likely to level off later this year. These developments should contribute to a more sustainable medium-term pattern of trade and current account balances. The G-5 meeting last September contributed to these developments. Our recent meeting in London showed that all countries were working to continue efforts for sustainable growth.

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The outlay reductions would be expected to bring down interest rates with a beneficial impact on the entire economy. In addition, lower interest rates and a declining budget deficit will moderate the rapid rise in interest expense that has developed. This will free up funds for growth in essential programs.

The time has come to reduce what has clearly become an excessive rate of growth in Federal spending and to move toward a balanced Federal budget.

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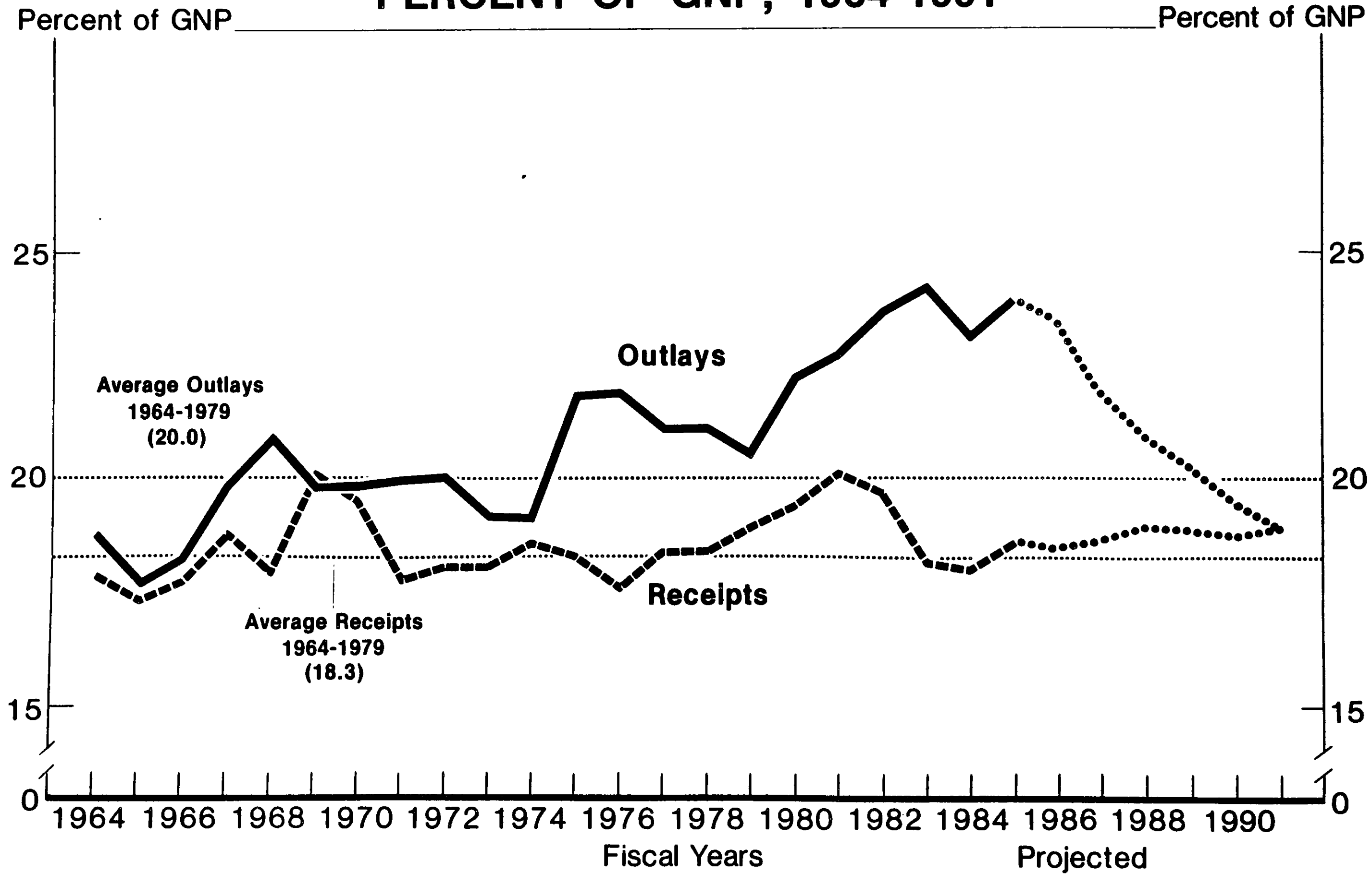

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February 6, 1986 A54a

TREASURY NEWS

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DEPARTMENT OF THE TREASURY

<u>For Release Upon Delivery</u>
Expected at 9:30 A.M.
February 19, 1986

Testimony of The Honorable James A. Baker, III
Secretary of the Treasury
Before the
House Budget Committee
February 19, 1986

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the state of the economy and the new budgetary path. The major economic objectives of the Administration have been described by President Reagan in his State of the Union Message. Further details on this year's economic and budgetary outlook have been provided in the President's Budget and Economic Report. My remarks are an overview of the current situation.

We seek to build on the foundation of the solid economic performance that has already taken place. The current economic expansion has now moved into its fourth year and shows few signs of slackening. Growth was relatively slow at some times during 1985, but by year-end the economy was gaining momentum.

Some favorable features of last year's economic performance deserve at least passing mention.

- Consumer price inflation at 3.8 percent remained in the 3.8 to 4 percent range for the fourth year in a row. A table attached to my prepared statement shows the steady progress that has been made since 1980 when all of the measures of price performance were rising in the double-digit range.

B-271

- Employment has risen strongly in the current expansion, by over 9-1/2 million people. The unemployment rate has been reduced to below 7 percent and further progress is expected. The U.S. economy continues to display great job-creating ability.

- Last year's financial market performance was also encouraging. Record amounts of credit flowed to private borrowers, despite the persistence of large Federal budget deficits. Short-term interest rates are down on average by about 1/2 percentage point in the past year while many of the long-term rates are down by about two percentage points. The prime rate is down to 9-1/2 percent, the lowest rate in 7 years. Ideally, we would like to have seen interest rates come down even further than they have.

All of this added up to a year of solid economic performance in 1985. The latest economic information is generally favorable. Employment rose sharply in January and the unemployment rate fell. Other statistics have not been quite as strong but the year is off to a good start. The stage has been set for sustained expansion in output, jobs and income.

Sustained economic expansion is one of the most important prerequisites for improving the budget picture, as well as the financial security of the American people. During the current expansion, strong economic growth has been achieved in a much less inflationary environment than in the late 1970's. We must strive to extend that good record into the future.

The Administration forecast calls for 4 percent real growth during the four quarters of 1986. This would seem to be a reasonable expectation. The consensus private forecast has been a little lower, around 3 percent. But the recent economic numbers are causing some upward adjustment in the private forecasts. Those of us who advise the President on these matters feel that the current Administration projections are inherently reasonable although we also recognize that economic forecasting is at best an uncertain art.

The inflation outlook is also relatively promising, although the fall in the external value of the dollar will eventually begin to exert a little upward pressure.

The Federal Reserve obviously needs to remain alert to the needs of both the domestic and international financial situations. While they never lack for critics and there is always room for disagreement on the wisdom of some of their specific actions, it seems to me that the Federal Reserve has been doing a good job recently.

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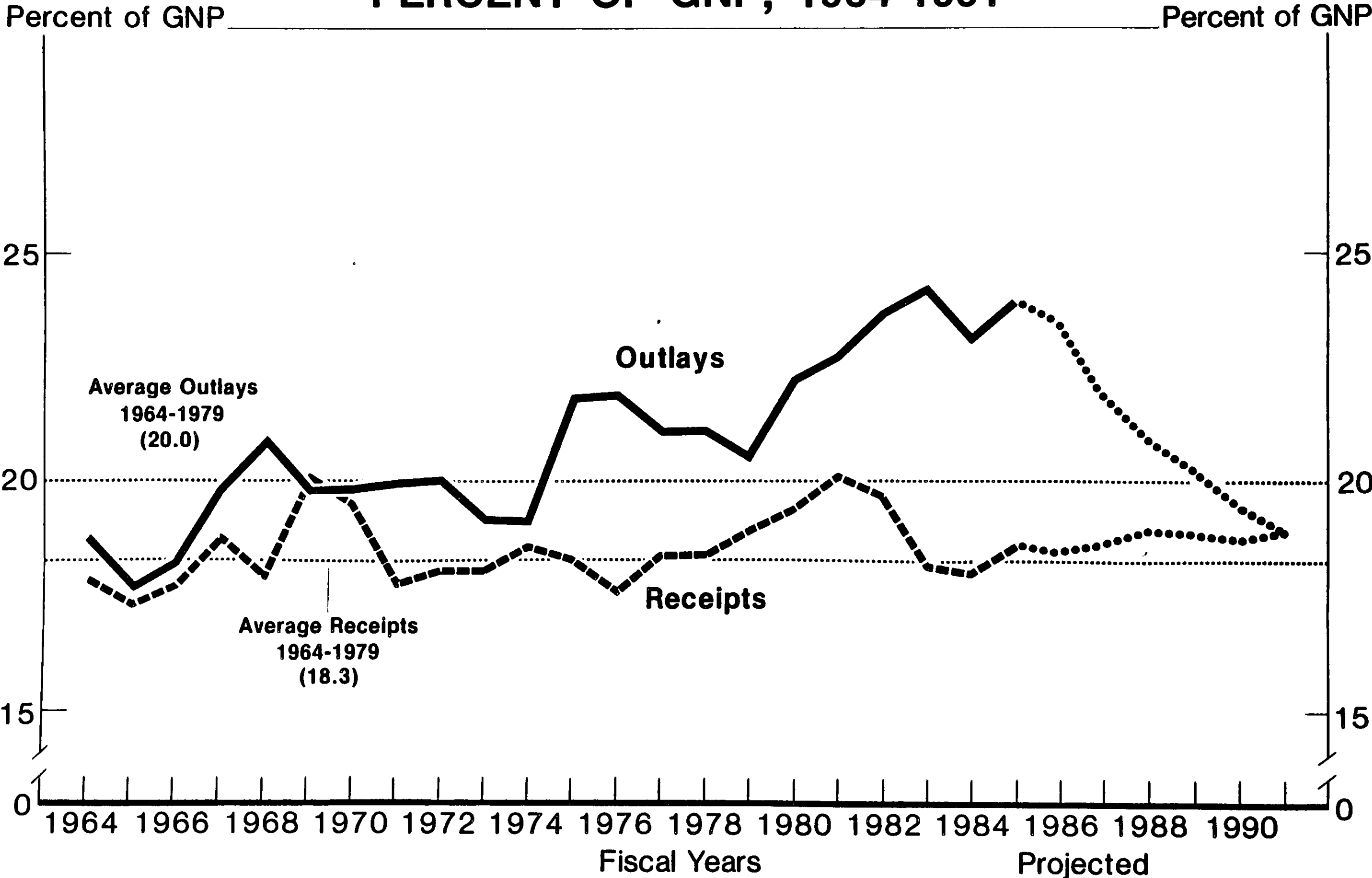

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February 6, 1986 A54a

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For Release Upon Delivery
Expected at 10:00 A.M.
February 20, 1986

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Secretary of the Treasury
Before the
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February 20, 1986

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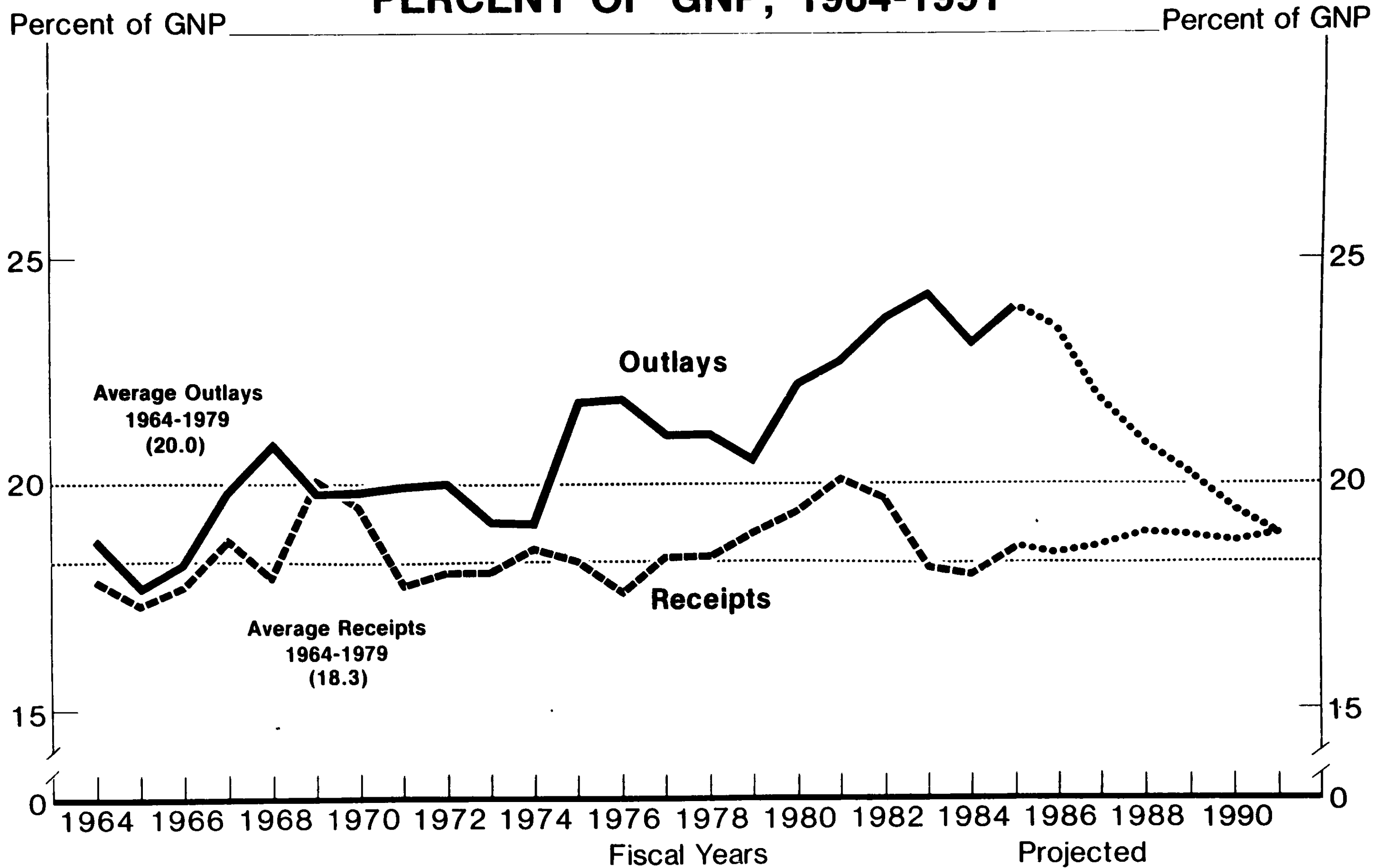
OUTLAYS AND RECEIPTS AS
PERCENT OF GNP, 1964-1991
Percent of GNP
Percent of GNP
25
20
15
0
Outlays
Receipts
Average Outlays
1964-1979
(20.0)
Average Receipts
1964-1979
(18.3)
1964 1966 1968 1970 1972 1974 1976 1978 1980 1982 1984 1986 1988 1990
Fiscal Years
Projected
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TREASURY NEWS

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DEPARTMENT OF THE TREASURY

STATEMENT OF CHARLES O. SETHNESS
ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE)
BEFORE THE SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS
FEBRUARY 18, 1986

Mr. Chairman and members of the Committee, I am pleased to be here today to discuss management of the Social Security old age ("OASI") and disability ("DI") trust funds, particularly during a debt limit crisis, and proposals for change. Last fall, when the debt limit was not increased until fully three months after it was reached, Secretary Baker was forced to take certain actions so that Social Security benefits continued to be paid. Some of those actions caused actual or potential losses to the trust funds. A similar situation occurred in 1984. Although the losses have now been cured, we, like you, are concerned about the situation and about any perception that the Secretary may have acted improperly. We therefore welcome the opportunity to work with you to make sure we all have a common understanding of the problems, and to find effective solutions.

The trust funds are at risk in three separate but inter-related areas during a debt limit crisis--payment of benefits, trust fund earnings, and trust fund security holdings. I think it is important to discuss each of these areas separately, because many of the proposals that have been made deal with only one part of the problem. I will then suggest a solution that we believe comes closest to ensuring the integrity of the trust funds and of the government's promise to pay benefits fully and on time.

Timely Payment of Benefits

Although the focus of congressional and public attention this fall was on the trust funds and their holdings rather than on the payment of benefits, that was only because benefits were actually paid. It is critical to recognize that many of the proposals that would protect the earnings or portfolio of the trust funds would not assure, and in fact might prevent, timely payment of benefits in a cash crunch caused by a debt limit

impasse. Let me briefly explain why this is the case.

The United States operates largely through a single checking account, into which virtually all money received by the government from whatever source is deposited and against which virtually all payments for whatever purpose are charged. Social Security checks are thus drawn on the same account as any other government check.

On the first of each month, estimated prospective Social Security receipts for the month are credited to the trust funds and invested as required by statute; the funds thus hold new interest-bearing securities, even though no Social Security taxes have yet been received.

Checks are mailed to be received on the third of the month. When those checks (and direct deposit payments) are paid, our single government account is reduced. For accounting purposes, the Treasury general account is charged with these payments, and trust fund securities are redeemed to repay the general account. Since benefits have already been paid out of the general account, when payroll taxes are received, they are simply credited to the same account. Under normal circumstances, this system results in both timely payment of benefits and maximum earnings for the trust funds, and is extremely efficient and cost-effective.

During most periods, especially when the government runs a total budget deficit (even if the Social Security program is running at a surplus), part of the cash that must be raised to make government payments comes from selling debt. If the debt limit prevents the sale of Treasury securities, the government will inevitably run out of cash, including the cash to pay Social Security benefits. It is currently virtually impossible for Federal Reserve Banks (although not the Treasury) to distinguish Social Security from other checks. If there is not enough money to pay all government obligations, no one can ensure that all Social Security benefits will be paid.

It is therefore important to recognize that, unless the cash transactions of the Social Security system were to be completely divorced from those of the rest of the government, removing obligations issued to the Social Security trust funds from the debt limit would not guarantee timely payment of benefits when the rest of the government is out of cash because of a debt limit problem. A separate payments system for Social Security would be expensive both to establish and to run, all to protect the funds against a crisis that should not happen -- the failure to increase the debt limit so that obligations already incurred can be paid.

Trust Fund Earnings

Interest earned by the trust funds is set by statute, which requires that new securities issued to the funds will earn

interest at a rate determined monthly based on the average market yield of all outstanding marketable United States securities that make up the public debt with more than four years remaining to maturity. Moreover, the pattern of trust fund purchases and redemptions has been established over many years and is essentially mechanical. When new money becomes available, it is invested in certificates of indebtedness that mature the following June. Redemptions are done shortest maturity first, with the lowest rate securities redeemed first within each maturity group. Each June, all maturing debt is rolled over into long-term debt at the June formula interest rate, with maturities spread over 15 years.

This system was the subject of hearings by this subcommittee in 1981 and 1982 and was analyzed by the National Commission on Social Security Reform in 1983. The National Commission stated that "the investment procedures followed by the trust funds in the past have been proper and appropriate." (Report of the National Commission on Social Security Reform, 2-22 (1983)) Because this part of the system operates essentially without discretion, we do not believe there is any conflict of interest relating to the Secretary's concurrent responsibilities to the trust funds and to manage the public debt. In response to the Chairman's request that the GAO look into this issue, the GAO stated in its December report "there is no evidence that the Secretary redeemed securities, or failed to invest funds, for the purpose of avoiding General Fund interest payments to the Trust Funds." (GAO Report B-221077, Appendix I, 13 (1985)

Although the current system operates without discretion, it is not entirely neutral as between the trust funds and the General Fund. For example, in a period of rising interest rates, the par redemption feature is essentially a subsidy from the General Fund to the trust funds. Conversely, when interest rates are falling, the General Fund receives the benefit from the par redemption feature. Similarly, using an interest rate formula based on long-term securities to set interest rates without regard to maturity provides a subsidy to the trust funds on their short-term holdings when the market yield curve is positively sloped (that is, when long term interest rates are higher than short term rates). The General Fund receives the benefit when short term rates exceed long term rates.

Let me digress a minute to discuss the effect of the normalized tax transfer (or "NTT") procedure on trust fund earnings. The NTT allows the trust funds to earn interest on funds not yet received. This extra interest must by law be returned to the General Fund. Because of this procedure, and the fact that interest is credited to the trust funds (as to all holders of Treasury notes and bonds) semi-annually, failure to invest the NTT on time because of the debt limit does not directly lead to a loss of interest unless the impasse is even more prolonged than it was last year.

The NTT was intended to address a potential cash flow problem that has largely disappeared given the projected surpluses of both OASI and DI. Moreover, we have identified certain problems with the operation of the NTT. For example, at a time of falling interest rates the NTT provides an unintended general fund subsidy to the trust funds when they are allowed to redeem new low rate securities that without the NTT they would not yet have acquired. The NTT also creates a large and artificial increase in the public debt at the beginning of each month. One alternative that would not disturb the existing trigger levels in Title II of the Social Security Act is to credit the normalized tax transfer but to require that the funds be invested only when the funds would otherwise be received. Thus, the artificial crediting and debiting of interest to the trust funds to put them in the position they would be in absent the NTT would not be necessary. H.R. 3688, introduced by Mr. Archer and Mr. Daub, would address the NTT. The Administration is now considering the full effects of the bill.

Repeal of the NTT would, however, mean that if the new money flowing into the funds could not be invested because of the debt limit, there would be an interest loss that could not be corrected without legislation. The interest loss in 1985 resulted almost entirely from the November transactions in which we redeemed securities several days early in order to make certain that benefits were paid when the government was out of cash, not from failure to invest the NTT. If we had not taken that action, benefits could not have been paid.

The Trust Fund Portfolio

The question of what securities the trust funds should hold has been studied many times since the funds were established. Each time, the conclusion has been that investments should be almost entirely in non-marketable United States Treasury obligations. There are a number of important benefits to requiring that a multibillion dollar fund, made up of mandatory contributions from virtually every employer and employee in the United States, be invested in non-marketable Treasury obligations.

Unlike a portfolio that can be invested in private companies or even in obligations that are guaranteed by the government, the trust funds' investments do not currently require the Managing Trustee to make judgments to favor specific social activities, corporations or other entities. The managers need not assess the potential and risk of alternative investments, assessments that could have a substantial impact on other investors' perceptions of those investments. Needed liquidity is assured, and issues and redemptions of billions of dollars of non-marketable securities each month do not cause market dislocations.

However, there clearly are steps that can be taken to improve the management of the trust fund investments during a

debt limit crisis. These include always debiting uninvested balances in the trust funds before redeeming securities to pay benefits and using any available debt limit capacity at the beginning, rather than the end, of each day to make trust fund investments. On the basis of recent experience, we could support legislation requiring such limited changes.

The inevitable result of changing procedures as described, however, would be that the government would run out of cash much faster when it had reached the debt limit. This means that if the crisis were prolonged, although trust fund earnings and the portfolio would be better protected, benefit payments could not be made. The result would be that, unless the changes in redemption and investment patterns were made legislatively, the Secretary would once again be faced, as he was last November, with a conflict--not between his debt management and trust fund investment roles, but between his duty to invest the trust funds and his duty to pay benefits.

We would therefore be happy to work with the committee to develop legislation to better protect trust fund earnings and holdings but we believe it is essential that any such legislation deal with the benefit payment problem as well as the fund investment problem. As demonstrated last year, the funds can be made whole by legislation enacted after the crisis is over; much more difficult and human problems will arise if benefits are not paid. In this respect, we support legislation that requires the Secretary to notify the other trustees and the Congress before he takes certain actions relating the the trust funds during a debt limit impasse.

What Is the Solution?

The best solution to this problem is to get and keep deficits firmly under control and thus reduce the need to increase the debt limit. However, even the Balanced Budget and Emergency Deficit Control Act of 1985 does not project a balanced budget occurring until 1991, and even then significant debt limit increases will be needed to permit the investment of the trust funds and other government investment accounts.

A more immediate solution to the trust fund investment problem and other problems as well, would be to repeal the debt limit. Without a debt limit, all new trust fund monies could always be immediately invested and cash would always be available to pay benefits.

There are other mechanisms to control spending and deficits, which require consideration of the proper amount of debt before rather than after the government incurs legal obligations. If repeal of the debt limit is not deemed to be desirable, the new budget procedures under which there would be a single budget resolution enacted early in the session, with more substantial sanctions for failure to follow it, suggest that the Senate

should, as the House does, automatically adopt an increased debt limit following enactment of the budget resolution.

Proposals for change limited solely to the Social Security system that respond to both the need to assure timely benefit payments and the needs of the trust funds are both difficult to craft and potentially quite expensive. For example, removing obligations held by the trust funds from the debt limit would fix the investment and earnings problem but would not insure the timely payment of benefits should the government run out of cash. In fact, because redemption of trust fund securities would no longer make room under the debt ceiling available for issuance of new Treasury debt to raise cash, the benefit payment problem could be exacerbated.

Conclusion

The events of last fall were unfortunate and, we hope, will not be repeated. There are modifications to the current system regarding timing of investments and patterns of redemptions that would be beneficial to the funds, as discussed above. However, because they could also have a negative impact on the ability to pay benefits, we are reluctant to implement them administratively. It would be far better to repeal the debt limit, or change it automatically as part of a budget resolution. Otherwise, as an unacceptably bare minimum, we can only hope to ensure that debt limit increases are enacted promptly. In any event, we need to make the day-to-day operation of the trust funds as error-free as humanly possible, and strive to improve public understanding of exactly how the system works.

TREASURY NEWS

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DEPARTMENT OF THE TREASURY

FOR RELEASE UPON DELIVERY
Expected at 1:00 p.m.
February 18, 1986

STATEMENT OF
ASSISTANT SECRETARY OF THE TREASURY
CHARLES O. SETHNESS
BEFORE THE
INTERIOR SUBCOMMITTEE
HOUSE COMMITTEE ON APPROPRIATIONS

Thank you for the opportunity to appear before you today to discuss the termination of the Synthetic Fuels Corporation. I am Charles O. Sethness, Assistant Secretary of the Treasury for Domestic Finance and have been charged by the Secretary and the Under Secretary for Finance with winding down the affairs of the corporation and transferring its continuing monetary and payment obligations as smoothly, quickly, efficiently and inexpensively as possible.

We view the process of liquidating the SynFuels Corporation as having two distinct parts. The first involves closing down the current operations of the corporation by April 18th and clearing up any remaining details as soon thereafter as is practicable. The second concerns ensuring that the ongoing projects that remain financial obligations of the United States Government are monitored properly after April in a manner that protects the Government's interests at the lowest cost. While both are proceeding at the same time, I would like to discuss them separately.

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Our immediate attention, due to the short time frame established in the Continuing Resolution, has been focused on closing SynFuels' offices. This involves many discreet projects such as lease terminations for office space and equipment, accounting matters, disposition of library materials, ensuring that management of the corporation continues smoothly as authority is transferred to the Secretary of the Treasury, and the like. Personnel payments, as you know, are being reviewed by the Office of Personnel Management and we have established a contact with that agency to ensure that final paychecks and pension matters are properly handled.

Although this part of the project is important, it is of short duration. A significant portion of our time has been devoted to the longer range issue of devising a method for protecting the Government's interests in the ongoing synthetic fuels projects to which the Goverment is committed, some of which will involve our monitoring well into the 1990s.

In this regard, we have been proceeding cautiously and discussing the options for managing this monitoring with a number of interested parties - for several reasons. First, the Treasury Department's expertise is in money, not in energy project engineering, technology or cost analysis, nor the other major area that is part of each of the projects, environmental protection. So we are trying to make certain that we set up a structure that will protect us where we lack resources.

Second, the Continuing Resolution prohibits the Secretary from

delegating any of his authority and responsibilities to any other agency. Because of this, we have determined that the best way to proceed is to hire a small staff of approximately 8 to 10 people to provide the energy, project and environmental expertise we need to match our capabilities in the financial area. (While the size and composition of this staff is not final, our intent is to keep it as small as possible. In addition, we plan to hire these individuals, at government rates, and on limited term appointments where possible, so that we will have the flexibility to alter the staff as we gain experience in this new area.)

The final reason for our deliberate and limited approach focuses on future relations with the Congress. We view our role in the SynFuels area as carrying out the direction given us by the Continuing Resolution. We have no interest in building a permanent structure in the Department to carry out energy-related programs. But we do want to meet our obligations concerning this project efficiently and effectively. To this end we welcome your advice and guidance and solicit your understanding that the SynFuels project places an unexpected -- and unplanned -- burden on the resources of the Department.

Thank you for your time; I would welcome any questions you may have.

TREASURY NEWS

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FOR RELEASE AT 4:00 P.M. February 18, 1986

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THE TREASURY

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $13,600 million, to be issued February 27, 1986. This offering will result in a paydown for the Treasury of about $1,100 million, as the maturing bills are outstanding in the amount of $14,698 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, February 24, 1986. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,800 million, representing an additional amount of bills dated November 29, 1985, and to mature May 29, 1986 (CUSIP No. 912794 KH 6), currently outstanding in the amount of $7,433 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,800 million, to be dated February 27, 1986, and to mature August 28, 1986 (CUSIP No. 912794 LB 8).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing February 27, 1986. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,473 million as agents for foreign and international monetary authorities, and $3,383 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, 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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TREASURY NEWS

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DEPARTMENT OF THE TREASURY

FOR RELEASE AT 4:00 P.M.

February 18, 1986

TREASURY TO AUCTION $7,500 MILLION OF 5-YEAR 2-MONTH NOTES

The Department of the Treasury will auction $7,500 million of 5-year 2-month 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.

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

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Attachment

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 5-YEAR 2-MONTH NOTES
TO BE ISSUED MARCH 5, 1986

February 18, 1986

<u>Amount Offered</u>:

To the public	$7,500 million

<u>Description of Security</u>:

Term and type of security	5-year 2-month notes
Series and CUSIP designation	J-1991 (CUSIP No. 912827 TJ 1)
Maturity Date	May 15, 1991
Call date	No provision
Interest Rate	To be determined based on the average of accepted bids
Investment yield	To be determined at auction
Premium or discount	To be determined after auction
Interest payment dates	November 15 and May 15 (first payment on November 15, 1986)
Minimum denomination available ..	$1,000

<u>Terms of Sale</u>:

Method of sale	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None
Payment by non-institutional investors	Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts ...	Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions	Acceptable

<u>Key Dates</u>:

Receipt of tenders	Wednesday, February 26, 1986, prior to 1:00 p.m., EST
Settlement (final payment due from institutions)	
a) cash or Federal funds	Wednesday, March 5, 1986
b) readily-collectible check ..	Monday, March 3, 1986

TREASURY NEWS

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FOR IMMEDIATE RELEASE

February 18, 1986

FEB 21 9 AM '86

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

DEPT. OF THE TREASURY

Tenders for $6,809 million of 13-week bills and for $6,816 million of 26-week bills, both to be issued on February 20, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 22, 1986			26-week bills maturing August 21, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	6.95%	7.17%	98.243	7.01%	7.37%	96.456
High	6.98%	7.20%	98.236	7.04%	7.40%	96.441
Average	6.97%	7.19%	98.238	7.03%	7.39%	96.446

Tenders at the high discount rate for the 13-week bills were allotted 87%.
Tenders at the high discount rate for the 26-week bills were allotted 01%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 42,915	$ 42,915	$ 36,070	$ 36,070
New York	18,542,865	5,798,245	21,175,785	5,751,735
Philadelphia	25,450	25,190	19,075	19,075
Cleveland	52,250	52,225	28,470	28,270
Richmond	70,525	67,275	79,500	54,500
Atlanta	41,550	36,550	95,980	85,980
Chicago	1,190,855	100,375	1,485,440	242,450
St. Louis	91,235	51,235	97,860	57,860
Minneapolis	63,675	35,425	46,410	21,410
Kansas City	67,725	57,805	51,865	51,865
Dallas	43,890	38,240	33,530	23,580
San Francisco	1,273,590	147,090	1,324,315	83,725
Treasury	356,765	356,765	359,390	359,390
TOTALS	$21,863,290	$6,809,335	$24,833,690	$6,815,910
Type				
Competitive	$18,743,370	$3,839,415	$21,402,715	$3,534,935
Noncompetitive	1,145,510	1,145,510	1,010,575	1,010,575
Subtotal, Public	$19,888,880	$4,984,925	$22,413,290	$4,545,510
Federal Reserve	1,720,210	1,570,210	1,700,000	1,550,000
Foreign Official Institutions	254,200	254,200	720,400	720,400
TOTALS	$21,863,290	$6,809,335	$24,833,690	$6,815,910

1/ Equivalent coupon-issue yield.

TREASURY NEWS

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FOR RELEASE UPON DELIVERY
FEBRUARY 19, 1986

FEB 21 3 43 PM '86
DEPARTMENT OF THE TREASURY

STATEMENT OF EDWARD T. STEVENSON
DEPUTY ASSISTANT SECRETARY OF THE TREASURY (OPERATIONS)
BEFORE THE
SUBCOMMITTEE ON CRIME
HOUSE COMMITTEE ON THE JUDICIARY
ON S. 49, H. R. 3155 AND OTHER LEGISLATION
WEDNESDAY, FEBRUARY 19, 1986

Mr. Chairman and members of the Subcommittee:

I welcome the opportunity to appear before you to address this Subcommittee on S. 49, H. R. 3155 and other proposed firearms legislation. In supporting and evaluating legislative proposals relative to firearms, we do so in light of the policy of this Administration. As President Reagan stated in 1983, "I look forward to signing a bill that truly protects the rights of law-abiding citizens, without diminishing the effectiveness of criminal law enforcement against the misuse of firearms." We are also mindful of the preamble of the Gun Control Act which states:

> . . . The purpose of this title is to provide support to Federal, State and local law enforcement officials in their fight against crime and violence, and it is not the purpose of this title to place any undue or unnecessary Federal restrictions or burdens on law abiding citizens with respect to the acquisition, possession, or use of firearms . . . .

Thus, the primary and overriding objective of firearms legislation must be to prevent the criminal misuse of firearms without infringing on the rights of law-abiding citizens to own firearms. In so doing, Federal law enforcement is charged with assisting State and local law enforcement agencies in their efforts to suppress crime and violence in our society.

With these principles in mind, the Treasury and Justice Departments and the Administration considered S. 49 and its predecessors and have endorsed this bill.

In arriving at this point, many months of discussions among the White House, Treasury and Justice Departments, the bill's sponsors, and members and staff of the Senate Judiciary Committee transpired. Our approach during these discussions was to strike a balance between the rights of law-abiding gun owners on the one hand and the requirements of law enforcement on the other. Admittedly, no legislation is perfect and this bill may not please all those having an interest in firearms legislation, whether they are sportsmen and other gun owners or those wanting more gun laws. However, we believe that from a law enforcement perspective, S. 49 represents an improvement over the bill as originally introduced in the Congress and does address some of the inequities in existing law.

Initially, I would point out that the bill as originally introduced contained several provisions that would strengthen existing law and remove burdensome requirements on licensees and the public. We readily concurred in these and they are still included in the bill. More specifically, the bill would repeal the ammunition recordkeeping requirements of the Gun Control Act that the Department has recognized have no substantial law enforcement value since ammunition is not generally traceable through licensee records. Significantly, the bill would close a loophole in existing law by prohibiting <u>any</u> person, not only licensees, from disposing of firearms and ammunition to felons and other proscribed categories of persons. Also, Federal firearms laws imposing disabilities on felons and other prohibited persons would be clarified by repealing most of Title VII of the Omnibus Crime Control and Safe Streets Act of 1968 and incorporating its provisions in the Gun Control Act. The Armed Career Criminal Act, imposing 15-year mandatory penalties on violators of Title VII having multiple robbery or burglary convictions, would be retained in Title VII.

By way of background, let me address some of the principal provisions of the bill which the Administration sponsors and the Senate Judiciary Committee were able to correct or strengthen in the interest of law enforcement.

First, with respect to interstate gun sales, S. 49 in its original form would have permitted unrecorded sales of firearms between unlicensed individuals residing in different States, as well as the interstate shipment of firearms by nonlicensees to other such persons. The Administration was successful in suggesting amendments to the bill to permit unlicensed individuals to acquire firearms outside their States of residence only if the firearms are obtained in person from a Federal firearms licensee and the transaction is lawful where the transferee lives and where the transaction occurs. Thus, S. 49 would permit law-abiding citizens who are eligible to purchase and possess firearms under Federal, State and local law to acquire firearms from licensees out of state. The channelling of these transactions in firearms through licensees, who must still keep Federal gun purchase records, will preserve the Government's ability to trace crime guns. The continued prohibition against licensees' sales of firearms to felons and other prohibited categories of persons, together with the records licensees must keep of their firearms transactions, will discourage felons and other prohibited persons from travelling interstate to purchase firearms.

In its original form, S. 49 provided for inspection of licensees' records and firearms inventories only if the Government had probable cause to believe that a violation of the Gun Control Act had occurred and that evidence of the violation might be found on the licensed premises. Warrants would have been required for all inspections. In effect, this provision would have eliminated compliance inspections carried out at the licensee's premises and made it virtually impossible to determine if an existing licensee qualified for license renewal or if grounds existed for license revocation. Also, we were concerned about access to licensees' records for the purpose of tracing crime guns, as well as gathering needed evidence in criminal investigations focusing on firearms purchasers. In the interest of effective law enforcement, we were successful in suggesting amendments to the bill to provide for several types of warrantless inspections or investigations: (1) in the course of criminal investigation of a person other than the license; (2) to make an annual compliance inspection; (3) and to trace firearms during a criminal investigation.

Another serious problem with the bill that was cured through our discussions relates to licensee reporting requirements under the Act. Initially, the bill could be interpreted to remove the statutory authority by which the Government may require licensees to report information from required records. Based upon this authority, licensees are currently required by regulations to provide information about particular firearms transactions on request, to report multiple sales of handguns to the same person, and to turn in to the Government out-of-business records upon ceasing business. Under S. 49 as passed by the Senate, these existing reporting requirements would be preserved and now specifically required by statute.

Originally, the bill would have required proof of the element of willfulness in a prosecution for any violation of the Act. If applicable to all Gun Control Act offenses, the new element would have made it extremely difficult to successfully prosecute many serious offenses. For example, in the absence of evidence that the defendant had specific knowledge that his conduct violated Federal law, he would not violate the law by receiving or possessing a firearm as a felon; transporting or receiving a firearm in interstate commerce with the intent to commit a felony with the weapon; transporting or receiving stolen firearms in interstate commerce knowing the firearms to be stolen; or using or carrying a firearm in the commission of a Federal crime. The Administration succeeded in amending the bill to require proof of a lesser element-knowledge-for those more serious crimes. The use of "knowingly" as an element will maintain the integrity of the criminal provisions of the Act and ensure that legitimate prosecutions can be maintained.

We were also successful in improving the forfeiture provisions of the bill. Initially, the bill would have eliminated the grounds for seizure and forfeiture of firearms and ammunition that the property was "intended to be used" in a violation of Federal law. Because this amendment was overly broad and would prohibit seizing firearms despite substantial evidence that they were intended to be used in violent or otherwise serious crimes, the bill was amended to allow the seizure and forfeiture of firearms and ammunition intended to be used in Federal crimes of violence and other specified crimes.

Turning to other legislation being considered by the Subcommittee, I would comment on those bills, namely H. R. 2024 and H. R. 3155, that would prohibit the transfer or possession of machineguns, weapons "readily convertible" to machineguns, and silencers and provide for the Secretary's purchase of those items. In our opinion, this legislation is unnecessary in view of the fact that machineguns and silencers are strictly regulated under existing law, the National Firearms Act. As you know, the NFA prohibits the making, transfer and possession of such weapons unless properly registered pursuant to approved applications for their making or transfer, and violations are punishable by imprisonment for terms not exceeding 10 years and $10,000 fines. The definition of "machinegun" includes, not only weapons that fire automatically, but those designed as machineguns, conversion kits, combinations of parts from which machineguns can be assembled, and the frames or receivers alone of machineguns.

A better approach would be to amend the NFA by strengthening the Act's definitions of machinegun and silencer. Amending these definitions to specifically include any part of a machinegun conversion kit and any part intended to be used in the assembly of a silencer would address the current law enforcement problem presented by the distribution of incomplete silencers and incomplete kits to convert weapons into machineguns.

In addition, it would be appropriate to amend the NFA to deal with the problem posed by individuals who, for the purpose of collecting personal NFA weapons, obtain a dealer's license under the Gun Control Act to deal in firearms generally and also pay the dealer's special (occupational) tax under the NFA. Having done so, the individual is then eligible to "deal" in NFA weapons, for example, machineguns. He is then able to acquire them interstate and defeat the transfer tax otherwise imposed on transfers of such weapons to non-special taxpayers. This person may also import, as dealer "sales samples,"weapons that otherwise are prohibited from importation. These weapons are often curios and relics of interest to collectors. After acquiring the personal weapons he desires tax-free, he allows his license and special tax stamp to expire. Several amendments to the NFA would help resolve these problems. First, those intending to engage in an NFA firearms business could be

required to file an application with the Secretary. This would enable the Secretary to determine that such persons intend to engage in a bona fide business before they are entitled to do so. Secondly, the term "transfer" could be expanded to include the retention of firearms by individuals who discontinue their so-called "business." These individuals would then be subject to the transfer tax on the weapons retained. Thirdly, the Act could be amended to preclude the importation of NFA firearms for use as "sales samples" if the firearms have been determined to be curios and relics. We will be glad to assist the Subcommittee in drafting the legislation suggested.

Consistent with our position that law-abiding citizens' ownership of firearms should not be unduly burdened by Federal regulation, we do not favor pending legislation imposing Federal requirements for handgun permits, licenses or registration or prohibitions on transactions in particular types of handguns. We believe that proposals such as these should be implemented by State and local governments if they so desire. Neither do we believe it appropriate to involve the Federal Government in the matter of civil liabilities of gun manufacturers and owners for injuries resulting from the misuse of firearms. Again, this is a matter best left to the States. We would, however, support legislation contained in two bills, H. R. 1442 and H. R. 3155, that would provide an additional administrative remedy with which to deal with Federal firearms licensees who violate the Gun Control Act. I am referring to the proposal to authorize the Secretary to suspend licenses which would provide an alternative to the only administrative remedy presently available - license revocation.

I would be glad to try to answer any questions you may have.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE February 19, 1986

FEB 21 3 43 PM '86
DEPARTMENT OF THE TREASURY

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,530 million of $22,319 million of tenders received from the public for the 2-year notes, Series W-1988, auctioned today. The notes will be issued February 28, 1986, and mature February 29, 1988.

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

	Yield	Price
Low	7.99%	100.018
High	8.03%	99.946
Average	8.02%	99.964

Tenders at the high yield were allotted 100%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 42,490	$ 30,490
New York	19,714,875	8,507,875
Philadelphia	22,100	22,100
Cleveland	61,785	60,785
Richmond	110,635	74,620
Atlanta	78,430	63,430
Chicago	1,047,270	289,270
St. Louis	147,675	130,675
Minneapolis	34,405	34,400
Kansas City	135,295	133,295
Dallas	32,785	27,785
San Francisco	885,860	149,360
Treasury	5,840	5,840
Totals	$22,319,445	$9,529,925

The $9,530 million of accepted tenders includes $826 million of noncompetitive tenders and $8,704 million of competitive tenders from the public.

In addition to the $9,530 million of tenders accepted in the auction process, $375 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $662 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE

LIBRARY, ROOM 5310

February 24, 1986

FEB 27 9 42 AM '86 THE TREASURY

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,809 million of 13-week bills and for $6,803 million of 26-week bills, both to be issued on February 27, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 29, 1986			26-week bills maturing August 28, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	6.88%	7.10%	98.261	6.95%	7.30%	96.486
High	6.98%	7.20%	98.236	7.01%	7.37%	96.456
Average	6.96%	7.18%	98.241	7.00%	7.36%	96.461

Tenders at the high discount rate for the 13-week bills were allotted 30%.
Tenders at the high discount rate for the 26-week bills were allotted 44%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 41,340	$ 41,340	$ 38,395	$ 38,395
New York	16,056,135	5,421,135	16,451,090	5,503,090
Philadelphia	27,650	27,650	22,440	22,440
Cleveland	41,220	41,220	34,400	34,400
Richmond	45,115	45,115	35,420	35,420
Atlanta	50,625	50,625	60,795	51,110
Chicago	1,241,660	261,660	1,345,345	425,345
St. Louis	67,850	39,350	88,255	53,255
Minneapolis	38,215	38,180	39,895	39,895
Kansas City	46,070	46,070	50,800	50,800
Dallas	36,245	31,245	31,095	21,095
San Francisco	1,208,905	453,905	1,464,430	183,430
Treasury	311,090	311,090	344,650	344,650
TOTALS	$19,212,120	$6,808,585	$20,007,010	$6,803,325
Type				
Competitive	$16,145,390	$3,741,855	$16,383,135	$3,179,450
Noncompetitive	976,945	976,945	923,975	923,975
Subtotal, Public	$17,122,335	$4,718,800	$17,307,110	$4,103,425
Federal Reserve	1,732,885	1,732,885	1,650,000	1,650,000
Foreign Official Institutions	356,900	356,900	1,049,900	1,049,900
TOTALS	$19,212,120	$6,808,585	$20,007,010	$6,803,325

1/ Equivalent coupon-issue yield.

B-480

TREASURY NEWS

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DEPARTMENT OF THE TREASURY

Release Upon Delivery
Expected at 11:00 a.m. EST
February 25, 1986

STATEMENT OF
STEPHEN E. SHAY
ACTING INTERNATIONAL TAX COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
OF THE HOUSE COMMITTEE ON WAYS AND MEANS

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to address this Subcommittee on the current status of the Treasury Department's efforts to negotiate and conclude agreements to exchange tax information ("tax information exchange agreements") with designated beneficiary countries under the Caribbean Basin Initiative ("CBI") legislation. This Administration believes that the combination of tax information exchange and the directly related tax benefits are an important element of the overall CBI program. International tax information exchange is important both to the United States and to our trading partners and allies on pragmatic grounds and as a matter of principle.

We consider exchange of tax information between nations with economic interrelationships to be a basic principle of international economic relations. We intend to continue to pursue improved tax information exchange in relations with our Caribbean neighbors as well as with our trading partners throughout the world. In this era of mutual economic and political interdependence, one member of a family of nations should not base its economic development on the systematic erosion of another member's legitimate tax base. The tax base of the United States, in particular, supports not only the important governmental functions common to sovereign states generally, but also supports a foreign aid program that provides very significant assistance to other countries in need. In addition, the United States funds a worldwide security shield that protects all friendly nations.

The connection in the CBI between tax benefits and tax information exchange is not a product of academic theory, but is based on very real needs of the United States. In an era of fiscal limitations, we cannot afford to extend tax benefits for economic development activity if tax shelter promoters and tax

evaders can take refuge in the anonymity afforded by certain countries. While information exchange agreements will themselves be beneficial to Caribbean Basin countries in administering their tax systems, the tax benefits that have been extended, and may be extended in the future, to Caribbean Basin countries that enter into tax information exchange agreements provide potentially significant economic opportunities to countries whose economies are in need of development.

The tax incentives for Caribbean Basin countries that have been linked to the conclusion of a tax information exchange agreement are the convention tax benefit and the Foreign Sales Corporation benefit. In addition, a provision in the tax reform bill recently passed by the House of Representatives has the potential for greatly increased capital investment in countries that conclude such agreements. I will discuss these benefits later in my testimony.

In exchange for these benefits, the United States requires the conclusion of a tax information exchange agreement that meets certain statutory requirements. I will also discuss the statutory requirements for an agreement, the benefits of an agreement for the contracting countries, and the status and progress of negotiations for agreements later in my testimony. Finally, I will discuss how an information exchange program operates and analyze the effectiveness of the present tax incentives in attracting Caribbean Basin countries to enter into these agreements.

I. Benefits of Tax Information Exchange Agreements to Caribbean Basin Countries.

The Convention Tax Deduction.

Section 222 of the Caribbean Basin Economic Recovery Act (the "Act") amended section 274(h) of the Internal Revenue Code of 1954, as amended (the "Code"), in 1983 to provide that a Caribbean Basin country that is designated by the President as qualifying for the trade benefits of the Act, and Bermuda, will be treated as part of the "North American area" for purposes of allowing deductions for ordinary and necessary business expenses of attending conventions and similar business meetings held in that country if the country in which the meeting is held has entered into an executive agreement to exchange tax information with the United States and does not discriminate under its tax laws against conventions held in the United States (a "qualifying country").

Because Barbados and the United States have concluded a tax information exchange agreement, and Barbados' tax laws do not discriminate against U.S. conventions, Barbados qualifies for the

convention tax benefit. Jamaica was extended the convention tax benefit prior to passage of the Act under a protocol to the income tax treaty between the United States and Jamaica. As the legislative history to the Act makes clear, the scope of tax information exchange under that treaty satisfies the statutory requirements for obtaining the convention tax benefit, even though there is no separately negotiated agreement that specifically addresses the requirements of the Code.

The convention tax benefit is a significant potential incentive to the tourism industry of a Caribbean Basin country. Although we cannot predict with precision resulting increases in tourism revenues, we are confident that the attractiveness of the region would ensure increased activity if meeting and convention costs are tax-deductible to U.S. taxpayers under the "North American area" rules.

Eligible Location for Establishment of Foreign Sales Corporations.

Section 801 of the Tax Reform Act of 1984 amended the Code effectively to replace the export incentive formerly provided by the Domestic International Sales Corporation ("DISC") program with the Foreign Sales Corporation ("FSC") program. A FSC is a specialized subsidiary of a United States exporter that must be organized under the laws of a foreign country or a U.S. possession and carry out substantial economic processes outside the United States in order to qualify for special tax treatment.

The Code provides specifically that a FSC must be created and organized under the laws of, and maintain a home office in, either a possession of the United States (other than Puerto Rico) or a foreign country that meets exchange of information requirements. A foreign country fulfills these exchange of information requirements if (1) it enters into a tax information exchange agreement, or (2) it has in effect with the United States an income tax treaty and the Secretary of the Treasury certifies that the exchange of information program under the treaty is satisfactory in practice.

The authority accorded the Secretary of the Treasury to find that information exchange with a treaty partner is satisfactory for purposes of the FSC information exchange requirement offers a more flexible standard than the standards required for a tax information exchange agreement, which I will discuss later in my testimony. It is appropriate to permit such an exercise of discretion with respect to a treaty partner. The United States only enters into tax treaties with countries that have income tax systems. Such countries generally have tax administration and enforcement procedures and a clear mutual interest in exchanging

information. The ability to exercise discretion permits the United States to take account of prior experience with the treaty partner both as a positive and a negative factor.

A Caribbean Basin country that becomes qualified for the convention tax benefit by entering into a tax information exchange agreement is also entitled to the FSC benefit. Thus, because of the tax information exchange agreement, Barbados qualifies for the FSC benefit. In addition, Jamaica and Trinidad and Tobago qualify for the FSC benefit because the Treasury Department found the information exchange programs under our income tax treaties with those countries to be satisfactory for purposes of the FSC information exchange requirement.

Qualification to serve as the home country for a FSC can provide a useful economic benefit to a Caribbean Basin country. The geographic proximity of the region and the interrelationships of languages and cultures with the United States may make these countries more attractive to U.S. businesses than more distant countries. The incorporation and location of FSCs in a qualifying country can provide additional employment opportunities in the office services sector and may encourage the public and private development of data processing and telecommunications systems that could serve these countries well in attracting other businesses that require such an infrastructure. Finally, the intangible benefit of raising the visibility of these Caribbean Basin countries in international trade may also be of significant potential value.

Possible Use of Section 936 Funds In Qualifying Caribbean Countries.

The tax reform legislation passed by the House of Representatives in December, H.R. 3838, authorizes the use of certain funds invested in Puerto Rico under Code section 936 for investments in Caribbean Basin countries that enter into tax information exchange agreements. A provision of H.R. 3838 would modify the tax benefit for investment in Puerto Rico ("section 936") to encourage the use of funds generating "qualified possession source investment income" ("QPSII") in Caribbean Basin countries that enter into such agreements with the United States. H.R. 3838 provides for the first time that QPSII funds deposited in the Puerto Rican Government Development Bank may also be used to finance investments in active business assets in qualifying Caribbean Basin countries, and passive income derived from those deposits would be tax exempt. Investment of such a large amount of funds would mean a significant increase in economic activity in the Caribbean Basin. This provision has the President's endorsement, solid bipartisan support and the wholehearted approval of the Government of Puerto Rico.

To promote the goals of this initiative, the Governor of Puerto Rico has spearheaded a drive to attract to the Caribbean Basin region "twin plants" related to projects in Puerto Rico. The Governor of Puerto Rico has indicated that Puerto Rico is committed to the ambitious goal of infusing $100 million of new investment into the Caribbean each year. The provision in the House bill on section 936, combined with Puerto Rico's twin plant initiative, offers one of the best prospects to date for stimulating investment in Caribbean Basin countries. The section 936 provision would be a powerful incentive for Caribbean countries to enter into tax information exchange agreements.

II. Tax Information Exchange Agreements.

Code section 274(h)(6) authorizes the Secretary of the Treasury to negotiate and conclude the exchange of information agreements that qualify a Caribbean country for the convention tax benefit, the FSC benefit, and, upon final passage by Congress of H.R. 3838, the section 936/twin plant benefit. The statute imposes certain minimum standards for such agreements. The exchange of information provisions in the agreements must authorize the Caribbean Basin country to fulfill specific requests for information by the United States with respect to civil and criminal tax matters involving U.S. citizens and residents, residents of the beneficiary country, and nationals or residents of countries other than the United States or the beneficiary country ("third-country persons"), notwithstanding any local nondisclosure laws regarding bank secrecy and bearer shares. Thus, a country that restricts disclosure of information regarding third-country persons or financial information would have to modify its law or practice with respect to requests for information by the United States.

A special rule provides for modified standards for exchange of information agreements that will qualify a country for the convention tax benefit in certain cases. This rule allows the requirement that the exchange of information agreement supersede provisions of local law regarding bank secrecy and nondisclosure of ownership of bearer shares to be waived in the case of information sought only for civil tax purposes if (i) the Secretary of the Treasury, after reasonable efforts to negotiate an agreement superseding such secrecy laws, determines that it is not possible to reach agreement but that the agreement negotiated will significantly assist the administration and enforcement of U.S. tax laws, and (ii) the President determines that such an exception to the standards for exchange of information is in the national security interest of the United States. The override of local law provisions requiring bank secrecy and nondisclosure of the ownership of bearer shares would continue to be required with respect to all criminal tax cases. No agreement has been concluded under this special exception.

Because tax information exchange agreements could be entered into with countries that have less sophisticated tax enforcement capabilities than the United States, or that have policies to attract investors that seek anonymity, the strict statutory standards for a tax information exchange agreement are intended to ensure that there is full information exchange with the United States. In July 1984, the Treasury Department, working with the Department of Justice and the Internal Revenue Service, formulated and issued a Discussion Draft of a CBI Exchange of Information Agreement (the "Discussion Draft") and a Technical Explanation thereof. The Discussion Draft provides guidance to other countries regarding a tax information exchange agreement. The Discussion Draft is intended to be comprehensive in raising issues that should be considered in arriving at an agreement, but Discussion Draft is not intended to be a model agreement. Although an agreement need not include all the provisions found in the Discussion Draft, the Treasury Department of course cannot modify the requirements of a tax information exchange agreement expressly stated in the governing statute.

III. Benefits of Tax Information Exchange Agreements to the United States.

As you are aware, the United States uses a self-assessment system in its collection of taxes. Each taxpayer files a return and pays the amount due on the return without governmental assessment. This is unlike the procedure in many foreign countries where the government sends each taxpayer an assessment of tax due.

Our self-assessment system relies in significant part on the perception by taxpayers that the tax system is equitable and that each person is paying his fair share. Noncompliance undermines the perceived and actual equity of our tax system and reduces the revenues obtained from the existing tax base.

The enforcement of our self-assessment system relies on a carefully targeted audit and examination program and, in appropriate cases, on application of criminal enforcement sanctions. A key element of an effective examination program is access to information. Information allows our examiners to confirm the information reported on a return and to discover those who would take unsupportable return positions, relying on the audit lottery or the unavailability of foreign information, as well as those who seek to evade tax.

The United States' tax interest under the Code extends beyond its borders. U.S. citizens and residents are taxable on their worldwide income. Moreover, under the subpart F, foreign personal holding company, and foreign investment company provisions of the

Code, a U.S. shareholder in a foreign corporation that is more than fifty percent owned by U.S. persons may be subject to tax on income measured by the earnings of the foreign corporation, even though it may not conduct any business in the United States. In addition, the Internal Revenue Service has broad authority under Code section 482 to reallocate income, deductions, or credits between two or more business owned or controlled directly or indirectly by the same interests in international as well as domestic transactions. Administration of these provisions requires that the United States be able to obtain information with respect to international transactions.

The need for international exchange of tax information also extends to information which may be used in criminal tax cases. In some international transactions it is impossible to uncover unreported income without the assistance of the foreign country in obtaining information which permits tracing the funds earned or the ultimate ownership of entities involved.

The tax information exchange agreements authorized in the CBI legislation assist the U.S. in promoting its goal of full information exchange among friendly neighbors and economic partners. However, they are only a small part of a larger agenda that the United States must pursue in order to achieve that goal. The more countries with which the United States has satisfactory information exchange, the more difficult it will be for tax evaders to avoid paying their fair share of tax.

The existence of tax information exchange agreements with other countries cannot alone solve our compliance problems involving international transactions. The primary focus for our resources must continue to be vigorous and efficient tax administration and enforcement in the United States. Tax information exchange agreements, however, are an important enforcement tool. Their utility is in part prophylatic; knowledge of their existence may reduce tax avoidance transactions involving use of countries that are parties to an agreement. While agreements require the cooperation of the other country, an effective international tax information exchange agreement makes it possible for the United States to follow those who would use that country in their efforts to evade their liability for U.S. tax.1/

The goal of the United States is to pursue full international tax information exchange in order to combat tax-haven operations that illegitimately erode the U.S. tax base. The conclusion of as

1/ Our experience in this regard with Barbados, though relatively limited, has been entirely satisfactory. Indeed, Barbados already has honored its agreement to provide information from bank records in one case.

many tax information exchange agreements as possible with Caribbean Basin countries will do much to advance the United States toward that goal.

IV. Status of Negotiations Regarding Tax Information Exchange Agreements.

As noted previously, the Treasury Department has successfully negotiated and concluded a tax information exchange agreement with Barbados. That agreement entered into force upon signature on November 3, 1984.

The United States has initialed agreements (which are not yet effective) with Costa Rica and the Dominican Republic. Preliminary informal discussions have been held with St. Lucia. Interest also has been expressed by a number of other countries; we are actively seeking to hold formal discussions with those countries.

One country, St. Kitts-Nevis, has objected that the requirement that tax benefits be conditioned on the conclusion of a tax information exchange agreement violates its sovereignty. While other countries have objected that the standards for information exchange are too onerous, they have not categorically rejected the possibility of entering into an agreement under any circumstances. However, it is clear that the internal laws of a few countries pose a major impediment to concluding an agreement unless the country is willing to modify its laws.

In addition to these discussions and negotiations, the Treasury Department is working with the State Department and the United States Trade Representative to meet with the U.S. representatives of the Caribbean Basin countries and to send information to U.S. embassies in the Caribbean Basin region to explain the tax information exchange agreements and to express Treasury's willingness to negotiate such agreements with interested countries.

V. Information Requests Under Information Exchange Agreements.

Because only one agreement that satisfies the standards of the Act has been concluded, the Treasury Department has limited statistics on the frequency of use of such agreements or the type of information requested. However, it is useful to review the data relating to requests for information under tax treaties.

The Internal Revenue Service generally obtains information located outside the United States through the efforts of Revenue Service Representatives (RSRs) stationed at 15 U.S. embassies and

consulates throughout the world. When an investigative branch of the Internal Revenue Service determines that foreign information is necessary, the Service directs the RSR responsible for the area where the information is located to attempt to obtain the information. In many instances, the information may be a matter of public record. If so, the RSR may obtain the information personally. In other instances, the RSR may contact the person with the information and request that it be turned over voluntarily. In many instances, the requested information will be provided voluntarily. If, however, the information is not public or provided voluntarily and it is located in a country with which we have an income tax treaty which includes an information exchange article, the Internal Revenue Service will make a formal request for information under the treaty. The effectiveness of such formal requests for information naturally varies with the particular country or type of information involved, but generally is satisfactory with respect to the majority of our treaty partners.

The RSRs participated in foreign investigations of 303 cases in FY 1985. In FY 1985 the United States also made a total of 170 formal requests of 21 treaty countries.2/ Almost half of these requests (82) were made of Canada. Of the remaining 20 countries of which requests were made, 15 received fewer than 5 requests, and 13 received fewer than 3. Fourteen of our treaty partners received no requests for information from the United States in FY 1985.

Under our information exchange programs, the requesting country must have a bona fide tax interest in the information requested. Such information may not be requested to enforce exchange control requirements, for example, or for political reasons. In addition, such information is subject to very strict confidentiality requirements under U.S. law. The Internal Revenue Service is prohibited from revealing such information even to other agencies and departments of the U.S. government except for purposes of enforcing tax laws. The United States expects that a similar level of confidentiality will be afforded to information obtained by a qualifying country under a tax information exchange agreement.

VI. Analysis of the Effectiveness of the Tax Incentives for Tax Information Exchange Agreements.

The United States believes that the convention tax benefit, the FSC benefit and the potential section 936 benefit provide useful and attractive incentives for Caribbean Basin countries to

2/ During that period, treaty partners made 316 formal requests for information from the United States.

enter into tax information exchange agreements. However, we understand that some countries perceive the detriments of entering into an agreement as outweighing the tax benefits. Although we believe that most of the perceived detriments are relatively minor, I will discuss these perceptions briefly in the interest of exploring the effectiveness of the present incentives.

First, it must be recognized that a small minority of Caribbean Basin countries base their economies on offshore banking industries that place heavy reliance on the continuance of bank secrecy. These countries believe that the elimination of bank secrecy with the United States would adversely affect their offshore banking sectors. They apparently believe that many of their depositors, desiring anonymity, would move their deposits to other jurisdictions. Thus, these countries do not feel that the benefits available for entering into an agreement would offset the possible effect on their banking sector. While the United States cannot condone the bank secrecy practices of tax havens, we recognize that these policies are a factor in why certain countries are not willing to enter into tax information exchange agreements.

A number of Caribbean Basin countries have expressed concern about the administrative burden that replying to information requests would impose on their relatively small governments. We believe that this concern is unfounded. It is unlikely that more than a handful of requests for information would be made. The statistics on requests for information from major trading partners, discussed above, evidence that the Internal Revenue Service will not inundate or overburden these countries with requests for information. A tax information exchange agreement should be a mutually beneficial mechanism to provide for information exchange when and if the need arises and only to the extent that such information is necessary to serve a bona fide tax interest of either country.

Some countries perceive that the information exchange agreement provides a "one-way street," with all of the benefit running to the United States. This criticism is based on two different theories. Countries that have no income tax or an income tax that is not concerned with foreign source income will not have a reason to request information from the United States and therefore, in effect, the agreement itself is not reciprocal. It is true that some countries may have little or no need to make information requests from the United States. However, this fact viewed in isolation does not negate the reciprocal nature of the agreements or diminish the value of the tax benefits that come with concluding an agreement.

Other countries believe that although they may occasionally have reason to request information from the United States, the instances would be so few, and the proffered benefits so uncertain, that the United States would have a clear advantage in the arrangement. This criticism is not well founded, but raises concern about the perception of the U.S. motives in linking the tax benefits of the CBI to tax information exchange agreements.

The special tax incentives available to Caribbean Basin countries that enter into tax information exchange agreements were enacted because of an overriding interest of the United States in the economic well-being of the region. Each of the tax benefits is carefully crafted to fit a need of the nations in the region. In exchange for extending these special incentives, Congress ensured by the condition of information exchange that the U.S. tax system will be strengthened, not weakened, by the legislation.

It is the view of the Treasury Department that the tax benefits available under current law provide an adequate inducement to enter into tax information exchange agreements for those countries that do not have highly developed offshore banking sectors that rely on bank secrecy. To achieve success, however, the United States must press its efforts to inform these Caribbean countries about the benefits, and dispel unfounded concerns about the detriments, associated with concluding an agreement. Moreover, we are confident that passage of the section 936 provision in H.R. 3838 would transform the attitude of many of these countries from that of skepticism to positive interest. We do not think it either appropriate or worthwhile to attempt to provide additional incentives, beyond those just referred to, for the purpose of inducing bank secrecy countries to conclude an agreement.

Conclusion.

I thank you, Mr. Chairman and Members of the Committee, for the opportunity to testify concerning this issue of great importance to the Treasury Department.

I would be pleased to answer any questions that you might have at this time.

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TREASURY NEWS

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

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FOR RELEASE AT 4:00 P.M. February 25, 1986

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $13,600 million, to be issued March 6, 1986. This offering will result in a paydown for the Treasury of about $1,300 million, as the maturing bills are outstanding in the amount of $14,908 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, March 3, 1986. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,800 million, representing an additional amount of bills dated December 5, 1985, and to mature June 5, 1986 (CUSIP No. 912794 KJ 2), currently outstanding in the amount of $7,619 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $6,800 million, representing an additional amount of bills dated September 5, 1985, and to mature September 4, 1986 (CUSIP No. 912794 KQ 6), currently outstanding in the amount of $8,806 million, the additional and original bills to be freely interchangeable.

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.

The bills will be issued for cash and in exchange for Treasury bills maturing March 6, 1986. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,319 million as agents for foreign and international monetary authorities, and $3,399 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, 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

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February 25, 1986

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DEPARTMENT OF THE TREASURY

THOMAS J. BERGER
APPOINTED DEPUTY ASSISTANT SECRETARY FOR
INTERNATIONAL MONETARY AFFAIRS

Secretary of the Treasury James A. Baker III has appointed Thomas J. Berger as Deputy Assistant Secretary of the Treasury for International Monetary Affairs.

Mr. Berger will play a key role in developing and implementing U.S. international monetary policies and will be particularly concerned with U.S. economic and financial relationships with other industrial countries.

Prior to becoming Deputy Assistant Secretary, Mr. Berger served, since 1983, as an advisor to the Saudi Arabian Monetary Agency (SAMA) and resided in Riyadh. His activities at SAMA focused on the ongoing development and implementation of an international investment program for the surplus oil revenues that Saudi Arabia built up during the 1970s and early 1980s. In addition, he was responsible for providing advice on investment policy, domestic fiscal and monetary matters, relations with foreign central banks and ministries of finance, and issues relating to international financial institutions and multilateral development banks.

Previously, Mr. Berger was a Vice President in the Investment Banking Division of Merrill Lynch Capital Markets in New York which he joined in 1977. While at Merrill Lynch he worked with U.S. and foreign corporations in arranging financings, both domestically and abroad. From 1973 until 1975 Mr. Berger was a corporate lending officer with Citibank, N.A. in New York.

Originally from Princeton, New Jersey, Mr. Berger holds a bachelors degree _cum laude_ from Harvard College and a masters degree in business administration from the Harvard Business School. Mr. Berger is 33, married and lives in Georgetown.

B-483

TREASURY NEWS

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STATEMENT BY
JAMES W. CONROW
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR DEVELOPING NATIONS
BEFORE
THE SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT INSTITUTIONS
AND FINANCE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
FEBRUARY 26, 1986

Thank you, Mr. Chairman, for the opportunity to appear before the Committee to discuss the environmental aspects of multilateral development bank activities.

The staff report issued by the Committee in December 1984 was a benchmark in the efforts of your Committee and the Administration to encourage constructive change in these aspects. Your report included nineteen recommendations, most of which we endorsed without qualification.

I would like to highlight four areas today:

-- where we stand with regard to organizational and procedural recommendations in each bank,

-- the recommendations which were directed to all the banks regarding training, environmentally beneficial projects and the inclusion of Environment and Health Ministers and nongovernmental organizations in the activities of the banks,

-- the elements of the recommendations which we have deferred,

-- and finally, a discussion of next steps -- where we go from here.

Organizational and Procedural Recommendations

Several of the recommendations in your report dealt with organizational matters and were directed to U.S. agencies, as well as the development banks. Since late 1984, the Treasury Department has been working closely with the State Department Bureau of Oceans and International Environmental and Scientific Affairs. The State Department will be elaborating on the Bureau's activities, but I would like to say simply that State has brought a welcome dose of expertise to our overall effort. We have found their initiative and advice adds to the effectiveness of U.S. policy.

The Bureau staff participates in the inter-agency Working Group on Multilateral Assistance where each project is reviewed by the Treasury and State Departments, the Agency for International Development, the United States Trade Representative, the Federal Reserve Board and the Departments of Agriculture, Interior, Labor and Commerce. Discussion of the environmental aspects of projects has become a regular feature of the Working Group, led by the staff of the State Department.

An important aspect of the increased attention to these issues by U.S. agencies is the inclusion of environmental factors in our early warning system. When a project first appears in the project pipeline of the banks, the U.S. embassy is sent a cable soliciting information about a range of policy issues. About a year ago, the environmental aspects

were added to the system, and responses from the field are giving us a basis for early discussions with the development banks.

Within the banks, there has been some progress toward organizational changes, although not entirely along the lines anticipated in your recommendations. The African Development Bank has an environmental specialist who has begun a program of staff training and has recommended Bank technical assistance support to prepare natural resource profiles for borrowing countries. While there is a greater awareness of the environmental dimension in Bank project proposals, the measures to deal with environmental aspects are not as well designed as we would hope.

For example, while the difficult resettlement and watershed management aspects of the La Mape dam in the Cameroons were identified when the project was put forward for approval last May, we would have preferred that plans to cope with these aspects would have been completed and funding identified.

While not designating an environmental coordinator, the Inter-American Development Bank established an internal Committee on the Environment in November 1983. I will be reporting to you more fully on its activities in the near future, but I would simply like to state today that this arrangement has the potential to address your concerns. Currently, the Bank's internal procedures are not as thorough as you and I might hope, but the Bank is making signifcant efforts to improve its effectiveness. We will be continuing to monitor the activities of the IDB Committee on the Environment in the coming months, and we will

keep you informed.

The World Bank has been perplexing. In many instances, the Bank has performed well. In others, Bank performance has been frustrating.

For example, a January $10 million IDA credit to Bangladesh for shrimp aquaculture included a component for shrimp hatcheries which will eventually be operated largely by the private sector. The hatcheries are an important step toward relieving pressure on the off-shore marine fisheries which are in danger of declining. The project also provided for using non-governmental organizations to implement a component to strengthen cooperation and understanding between the local farming and fishing communities. In a second project, a forthcoming $20 million IBRD loan to Malawi for fuelwood planting is well-targetted to relieve pressure on the country's rapidly disappearing forest resources.

By contrast, in December, the Bank approved a $50 million loan to Malaysia to provide infrastructure for a land settlement project which will lead to clearing 20,000 hectares of tropical forest. In 1958, eighty percent of peninsular Malaysia was forested; now, less than 49 percent is forested. While in many respects land settlement projects in Malaysia have been successful, I find troubling the absence of an effective environmental assessment process that can be used to establish a land use plan which will effectively delineate tropical forest reserves. In another project in October, the Bank provided Indonesia a $32 million loan to finance the procurment and distribution of draft livestock in support of the trans-

migration program in Sumatra and Sulawesi. In addition to forest clearing, the livestock are undoubtedly going to be used to prepare fields for crops, such as rice. But the soils on these two islands generally cannot sustain annual cropping, so that in a year or two the farmer will clear more forest for his crop. The result will be more extensive deforestation, with relatively meager increases in agricultural production.

While the overall picture in the Bank remains mixed, there has been some encouraging movement. Last November, the Bank began an internal review of natural resource use problems that have arisen in past Bank projects, especially in agriculture and energy projects. The review is expected to last about two years and may yield significant changes in policies and procedures. While the timeframe appears extended, the subject is vast and research by external experts will play an important role. We will monitor protress and keep the Committee informed.

While the Committee did not direct a recommendation specifically to the Asian Development Bank, I can report that a Board review of environmental policies and procedures in January confirmed two steps which I believe are useful and important:

-- the responsibilities of the two environmental specialists of the Bank have been re-defined so that more of their effort can be directed toward the environmentally sensitive sector of energy and agriculture; and

-- the Bank's useful technical assistance programs to conduct regional planning studies which emphasize the use of natural resources will be expanded. The study of the Han River Basin in Korea, begun in 1981, has already led to several projects to control water pollution.

In other respects, the performance of the Bank continues to be mixed. Nepal, which has had severe deforestation and soil erosion problems, was the beneficiary of two constrasting projects in October 1985. A $14 million loan for livestock development included provision for livestock exclusion areas where overgrazing has been a severe problem and for selection of fodder crops to improve nutrition and provide soil cover. By contrast, a $20 million loan for rural development in Seti zone of Nepal is likely to lead to further deforestation in the southern portion of the region and to the expansion of cropping, without terracing, in the hilly northern portion -- both adding to the soil erosion problem.

Training

Beyond organizational matters, your Committee's report also suggested that the World Bank's Economic Development Institute might usefully strengthen its training efforts in the environmental area. The Institute is offering about ninety courses in all parts of the world during the current academic year. On the basis of the Institute's published catalogue, we judged that environmental considerations might usefully be included in about one-third of the courses.

In recent months, we have had several meetings with the staff of the Institute. It is apparent that the course offerings are heavily oriented toward reaching developing country officials who analyze or decide economic policies. In this context, environmental considerations might be introduced most effectively by including articulate officials of agencies responsible for environmental matters in mixed courses with economic policy officials. In addition, appropriate course materials and group discussion leaders with environmental backgrounds could make useful contributions.

We have not reached firm conclusions. But, at this stage, we are considering a recommendation that the Institute hire a consultant to systematically review all courses, to recommend appropriate course participants in environmental fields, and to suggest appropriate course materials and lecturers.

Environmentally Beneficial Projects

A third important area in which the Committee has made recommendations is the encouragement of environmentally beneficial projects in the banks. As I mentioned -- and as is widely recognized -- the banks currently do environmentally beneficial projects. I hope that, in our concern about some projects, we don't lose sight of the positive aspects of development bank activities.

In deciding what types of environmentally beneficial projects to propose systematically to the banks, we have adopted one of the suggestions in your report and are discussing irrigation management with the World Bank staff. A second topic we are pursuing cuts across several of the suggestions your report

put forward. In September, 1985, a Washington-based non-governmental organization, the World Resources Institute, issued a report containing a large number of ideas for project activity that might be undertaken in 56 developing countries. Included are suggestions for fuelwood projects, watershed management projects, industrial timber development and forest preservation proposals, as well as institution building. We are planning to discuss these ideas with the World Bank to determine whether they offer a basis for project activities. If the results of our conversations with the Bank are promising, we expect to extend our discussions to the regional development banks. We will keep the Committee informed of progress on these subjects.

Participation of Ministers and Nongovernmental Organizations

In a fourth area, your report recommends greater involvement of Environment and Health Ministers and nongovernmental conservation and indigenous peoples' organizations in project planning and implementation. The reports we have submitted to the Committee indicate that the banks were supportive of these ideas, in principle, but were cautious with regard to systematic implementation. I believe this is an area where we can make greater efforts and I am asking our Executive Directors in the banks to propose that appraisal reports for projects in sensitive sectors include specific statements describing either the role of such Ministers and organizations in project preparation or why such a role was unnecessary.

Deferred Recommendations

Three of the recommendations in your report have seemed to us inappropriate to implement at this time. First, the recommendation that we earmark a fixed proportion of MDB lending programs be earmarked for environmental projects does not seem to us to be a positive approach. Setting dollar denominated targets, in our experience, has been a poor management technique in the development banks. Success should be measured by quality, not quantity. While we want to encourage environmentally sound and economically beneficial projects, we do not believe targetry will prove effective in the end.

Second, we would prefer not to establish firm criteria for supporting or opposing projects. We are confident that the senior managers of the banks have a genuine commitment to sustainable development and that our persistence in calling questionable projects to their attention will yield the changes we are all seeking. Furthermore, the banks, in designing projects, need to pursue a range of objectives, some of which may be in conflict with sound environmental practices. Compromise may be necessary. I have already mentioned that land settlement projects in Malaysia have led to deforestation. Some of these projects have also lifted a sizable number of the landless, rural poor into the middle class of that country. Rigid criteria may compromise other objectives, such as poverty alleviation, which we expect the banks to pursue.

Third, I continue to believe that a fixed requirement for a generalized annual report is unnecessary. We have been keeping you informed of developments regularly and we will continue to do so. But annual reporting requirements too often outlive their utility, and we propose to defer this recommendation.

Where We Go From Here

I believe that the work that this Committee started in June, 1983 is having a salutary effect on the banks. Their response has not always been as rapid nor as complete as we may have hoped, but your concerted effort to maintain a constructive approach is yielding benefits. There is awareness of broad concern and a genuine desire in the banks to support sustainable development, in terms of environmentally sound and economically productive projects.

I see two major tasks before us in the coming months. The first is to focus the discussion about environment and development on concrete issues -- specifically, on the more difficult types of project associated with agriculture in tropical regions, impoundments of rivers and penetration roads into relatively uninhabited regions. In order to give the banks a clearer sense of policy direction, I believe it is time to make a concerted effort to engage other donor countries in a discussion of these problems and to encourage them to provide their executive directors in the banks with policy guidance. I have begun the process in meetings I attended in January and February, and my clear impression was that

my counterparts in other governments are going to look into these aspects of bank activities. I plan to continue the dialogue in the coming months and foresee that we will be able to arrive at a consensus which will furnish the banks with clear views from major shareholders. We think it may also be desirable to begin a more direct dialogue with selected developing countries on the environmental aspects of their national development activities. We will be discussing this further with the State Department in the coming weeks.

The second task before us in the months ahead is to continue to raise these environmental concerns within the banks at senior levels -- both in the context of specific projects and in broader policy terms, where we will raise such issues as the role of nongovernmental organizations in development activities. These discussions will serve the dual purposes of conveying our continuing concern and of providing an opportunity to engage directors representing other countries in the dialogue which can lead to a broad consensus for change. I am prepared to commit the Treasury Department and our Executive Directors to such discussion.

Mr. Chairman, I believe we are half way to achieving strengthened environmental policies and procedures in the banks. Much remains to be done, but the task of drawing attention to the issues is now completed. We should continue our efforts in a responsible and constructive manner. We need to be clear; we need to be specific; and we need to be constant. I know we have your support and that of your Committee in this effort.

Thank you.

TREASURY NEWS

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

(CORRECTED COPY)

For Release Upon Delivery
Expected at 9:30 a.m., EST
February 27, 1986

STATEMENT OF
J. ROGER MENTZ
ACTING ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to discuss the Treasury Department's views regarding the imposition of excise taxes on the importation of crude oil and refined petroleum products. In particular, the Subcommittee is reviewing S. 1507 and S. 1997, each of which would impose an excise tax or tariff on crude oil and refined petroleum products that are imported into the United States.

Before discussing these bills in detail, I wish to emphasize the Administration's strong opposition to any tax increase, including any new or increased taxes on petroleum or other sources of energy, for any purpose other than as a component of a fundamental tax reform bill that is revenue neutral in total. While the Federal budget deficit remains a major problem, the Administration believes strongly that the deficit can and should be eliminated through substantial reductions in nonessential domestic spending, not by a tax increase in any form.

The Administration remains firmly committed to the enactment this year of a revenue-neutral tax reform bill. It is in the context of such a bill, if at all, that the Administration would be willing to consider supporting taxes of the type proposed by S. 1507 and S. 1997.

Background

Tax Provisions. There are presently a variety of specific taxes applicable to crude oil and refined petroleum products. Under the Crude Oil Windfall Profit Tax Act of 1980, a Federal excise tax is imposed on certain domestic crude oil. In general, the amount of the tax depends upon certain characteristics of the oil, such as when it was discovered and its method of production, and the difference between the value of the oil upon removal and

statutorily specified base prices. Because the removal price of oil has been falling, while the inflation-adjusted base prices have been increasing, the revenues generated by the windfall profit tax have been rapidly declining. 1/ The tax is scheduled to phase out over a 33-month period beginning in 1991. 2/

Imported crude oil is not subject to the windfall profit tax. Under the Tariff Schedules of the United States, however, a tariff is imposed on imported crude oil and certain refined petroleum products at rates ranging from approximately five cents per barrel on certain crude oil (0.125 cents per gallon) to 84 cents per barrel on certain refined products (two cents per gallon). A higher rate applies to products imported from certain communist countries, and some refined products may be imported from Canada without any duty. These tariffs, which are imposed under the Tariff Act of 1930, are not designed principally to raise revenue and do not significantly affect the cost of oil or refined products. 3/

Finally, Federal excise taxes, at rates ranging from three cents per gallon to 15 cents per gallon, are imposed on gasoline and other fuels. These excise taxes do not increase general revenues, but are dedicated to the Highway Trust Fund, the Airport and Airway Trust Fund, and the Inland Waterways Trust Fund. The Highway Trust Fund excise taxes are currently scheduled to expire on September 30, 1988, and the Airport and Airway Trust Fund taxes are scheduled to expire on December 31, 1987.

Energy Consumption. The percentage of U.S. energy consumption supplied by imported crude oil and refined petroleum products has been declining since 1977, when nearly 48 percent of our gross oil supply was produced abroad. By 1981, our reliance on imported oil and oil products had declined to 36 percent of domestic consumption. This trend continued in 1985, during which 31 percent of U.S. gross oil consumption was supplied by imported products. Net imports in 1985 represented only 27 percent of domestic consumption.

1/ During 1984, the windfall profit tax raised $3.9 billion in net revenues. If the average removal price during 1986 decreases to $18 per barrel, the revenue raised by the windfall profit tax will be negligible.

2/ The phase-out period could begin in 1988 if the cumulative net revenues raised by the tax exceed $227.3 billion. Under current assumptions regarding oil prices, however, we do not expect the phase-out period to begin before January 1991.

3/ In addition to the general Tariff Schedules of the United States, the President has authority under the Trade Expansion Act of 1962 to impose oil import fees or other restrictions if he finds that imports threaten national security. This authority, which has been used several times, is subject to Congressional override.

Description of the Bills

S. 1507, sponsored by Senators Boren and Bentsen, would increase the existing tariff on imported crude oil by $5 per barrel, and would increase the existing tariffs on refined petroleum products by $10 per barrel. The $5 additional tariff on crude oil would begin to phase out when the average world price of crude oil, as determined quarterly by the Secretary of Energy, reached $25 per barrel, and would be eliminated when the average world price reached $30 per barrel. Similarly, the $10 additional tariff on refined products would be phased out for each product as the average world price of the particular product moved from $25 per barrel to $35 per barrel.

The increased tariffs imposed by S. 1507 would be refunded with respect to any barrel of crude oil or refined petroleum product that was used as heating fuel or in the production of heating fuel. In addition, the tariff would be refunded for any crude oil or refined petroleum that was "necessary and inherent" to the manufacture of any products destined for export. In each case, the bill contemplates that the Treasury Department would, by rules and regulations, provide the procedures under which qualification for a refund of the tariff would have to be proven.

Finally, S. 1507 would express the sense of the Congress that the net increase in Federal revenues resulting from the new tariffs should be used to reduce the Federal budget deficit.

S. 1997, sponsored by Senators Wallop and Bentsen, would impose a new excise tax on the first sale or use within the United States of crude oil or refined petroleum products that have been imported. The amount of the excise tax on each barrel of imported crude oil would be equal to the difference between the average world price per barrel of crude oil and a statutorily prescribed floor, set initially at $22 per barrel. The amount of the floor, sometimes referred to as the "survival price" of oil, would be increased annually to account for growth in per capita nominal gross national product. 4/ The average world price of crude oil would be determined quarterly by the Secretary of the Treasury, in consultation with the Secretary of Energy, based on the average per barrel prices for three principal classes of foreign crude oil. 5/

4/ The GNP-adjusted reference price would be rounded off to the next highest dollar. Based on current budget projections, this annual increase would average approximately six percent per year over the fiscal 1986-1991 budget period.

5/ The three classes of foreign crude oil are Rotterdam brent crude, Saudi light, and North Sea forties.

The amount of the excise tax imposed under S. 1997 on each barrel of imported refined petroleum products would be equal to the per barrel excise tax on imported crude oil, increased by a $3 per barrel "environmental outlay adjustment," 6/ multiplied by a barrel of oil equivalent factor. This factor appears to be the ratio of the Btu content of a barrel of refined product to 5.8 million Btu, the content of a barrel of oil. Thus, for example, if the average world oil price were $16 per barrel, the excise tax on a barrel of imported motor gasoline, which yields 5.25 million Btu, would be approximately $8.15. 7/

S. 1997 would exempt from the tax any refined products imported for use as home heating fuel. Unlike S. 1507, however, the bill would not exempt from tax imported crude oil that is imported and refined for use as heating fuel. Further, the bill would provide exemptions for residual fuel oil and for topped crude oil imported for further refining, for "process fuels," and for liquid natural gas. While the scope of the "process fuels" exemption is not clear, it would presumably apply to petroleum products used in certain industrial applications. Finally, S. 1997 would exempt from the new excise tax any crude oil or refined petroleum product that was sold for export within six months following its importation.

Discussion

Although the two bills described above differ in various respects, they share the obvious characteristic of imposing a fee on most imported oil and refined petroleum products, and thus raise a series of common considerations. Except as otherwise indicated, the discussion below applies to both proposals.

We face today crude oil prices that have fallen dramatically. The spot price for West Texas intermediate crude oil, for example, closed Tuesday at $14.55 per barrel, as compared

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6/ The environmental outlay adjustment would be increased annually to account for per capita GNP growth in the same manner as described above with respect to the statutory floor on the price of oil.

7/ The $8.15 excise tax on a barrel of motor fuel would be computed as follows:

Reference price	$22
World oil price	($16)
Tax on crude oil	$ 6
Environmental Outlay Adjustment	$ 3
Tentative refined product fee	$ 9
"Barrel of oil equivalent" factor (5.25 Btu ÷ 5.8 Btu)	x .905
Motor fuel excise tax	$8.15

to its recent high price of $31.80 per barrel on November 21, 1985. The falling price of crude oil, its effect on the prices of refined petroleum and other sources of energy, and the effect of these price reductions on both the economy in general and on particular regions of the country must obviously influence our consideration of these proposals to impose a fee on imported oil.

Effect on Federal Revenues. As already noted, the Administration would consider the imposition of a fee on imported oil and refined petroleum products only in the context of a revenue-neutral tax reform bill. The President has stated that the House-passed tax reform bill (H.R. 3838) fails in several respects to meet his minimum requirements for an acceptable bill. Many of the improvements suggested by the President, as well as others that have been mentioned by members of the Finance Committee, would entail a significant loss of revenues. Thus, the revenue raised by a tax on imported petroleum could be used to maintain the revenue neutrality of a bill that included the suggested changes. Accordingly, the revenue effects of the proposals being considered by this Subcommittee are an important factor to be considered.

The potential revenue raised by the imposition of a tax on imported oil and refined petroleum products differs depending upon the structure of the proposal. Our analysis shows that the overall revenues (including windfall profit tax collections) raised from a fixed fee or excise tax are not acutely sensitive to the precise level of world oil prices. Thus, a fixed $5 per barrel excise tax would raise roughly the same amount of revenue regardless of whether the world price of crude oil was $20 or $25 per barrel. S. 1507 and S. 1997, however, establish in varying ways an import fee that is explicitly dependent upon the level of world oil prices. Accordingly, the revenue raised by each of these proposals, unlike a fixed fee, would be sensitive to changes in the world oil price.

Assuming an October 1, 1986 effective date and oil prices that remain $4 per barrel below the Administration's latest forecast, 8/ and assuming all other elements of the forecast are

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8/ The latest Administration forecasts, prepared in December 1985, assume that crude oil prices will be as follows:

Year	Price per barrel
1986	$24.76
1987	23.98
1988	23.55
1989	24.07
1990	24.95
1991	25.37

not affected by the imposition of the fee, we estimate that S. 1507, which would impose a $5 per barrel tariff on imported crude oil and a $10 per barrel tariff on imported refined products, would increase revenues by approximately $35.7 billion over the fiscal 1987-1991 budget period. 9/ Because the tariff is phased out as the world price of oil increases from $25 to $30 per barrel and the world price of refined products increases from $25 to $35 per barrel, however, we note that this revenue would not be realized if the current decline in world prices were reversed and prices rose again to their former levels.

Again assuming that the average world price of crude oil remains $4 per barrel lower than the latest Administration economic forecast, that all other elements of the forecast are not affected by the imposition of the fee, and that the bill becomes effective on October 1, 1986, we estimate that S. 1997 would raise approximately $26.0 billion over the five-year budget period. If the average world price drops more than $4 per barrel below the latest forecast, of course, a greater amount of revenue would be raised annually under S. 1997. 10/

The provisions of S. 1997 raise even greater uncertainty than S. 1507 in estimating likely revenue effects. In particular, because the rate of tax under S. 1997 depends more directly upon the price of oil, the revenue that it would raise would be even more sensitive to fluctuations in world oil prices than the revenue raised under S. 1507. Given the volatility of oil prices and the influence of foreign governments on these prices, it is difficult to depend upon the taxing mechanism provided in S. 1997 as a stable source of a specified level of revenue over an extended period. Moreover, in a manner similar to S. 1507, the revenue that would be raised by S. 1997 would vanish if the average world price of oil exceeded the adjusted reference price.

9/ The $35.7 billion estimated to be raised consists of $31.2 billion in net oil import fees (which reflects a reduction in imports resulting from the fee) and $4.4 billion in additional net windfall profit tax collections. This estimate of the revenue effect of S. 1507 takes into account the exemptions contained in the bill for heating fuel, and oil or refined products used in the manufacture of goods destined for export. If the exemption for home heating fuel were deleted, we estimate an additional revenue increase of $5.7 billion per year. Deletion of the exemption for oil and refined products used to manufacture exports would increase the revenue gain by approximately $1.2 billion.

10/ The $26.0 billion revenue estimate consists of $19.4 billion in net oil import fees (which reflects a reduction in imports) and $6.6 billion in additional net windfall profit taxes. Our estimate of the revenue effects of S. 1997 reflects our interpretation of each of the exemptions contained in the bill. If the provisions of S. 1997 were applied without the exceptions for products and for petroleum products exported within six months of importation, we estimate that an additional $24.3 billion would be raised during the budget period.

As the foregoing analysis suggests, we must be careful not to assume that the revenue raised by oil import fees of the types proposed in S. 1507 or S. 1997 will always be available to maintain the revenue neutrality of a tax reform bill. Indeed, there is a high degree of uncertainty in predicting the revenue effects of any variable oil import fee. Under today's market conditions, this uncertainty is a major detriment of an oil import fee whose purpose is to ensure that a tax reform bill is revenue neutral.

National Security Considerations. The tax treatment of natural resources has long been important in maintaining a viable domestic energy industry, which is an integral element of our national security. Consequently, the effect that an oil import fee would likely have on the domestic energy industry is a critical factor that must be considered.

There has been a slow, steady decline in world oil prices since 1981. 11/ The domestic oil industry, which includes oil-drilling and well-service contractors, oil tool and pipe manufacturers, and many other businesses, as well as oil producers and refiners, has been forced to adjust gradually to this decline in energy demand, oil prices, and drilling activity. However, the rapidly falling world oil prices encountered recently, if continued, raises the possibility of a greater threat to the strength of the domestic oil industry and will significantly affect the level of exploration and development of our domestic energy resources.

Indeed, several major oil companies recently announced substantial reductions in their domestic exploration and production budgets, and similar announcements from other companies are widely expected. Moreover, if the price of oil continues to fall, many of this country's "stripper wells" (i.e., wells producing on average less than ten barrels of oil each day), which comprise approximately 15 percent of domestic oil production, will be made unprofitable and may be prematurely abandoned.

Because the prices of other sources of energy are related to the price of oil, this reduction in exploration and development may eventually spread to other energy sources such as coal and natural gas. Ultimately, reduced levels of domestic exploratory and developmental activity will lead to reduced domestic production. In the face of both this lower domestic production and greater domestic demand resulting from falling prices, oil imports will increase, leading to greater dependence on foreign oil in the near term.

11/ In 1981, the average domestic oil well-head price was $31.77 per barrel. This price has been declining steadily until 1985, when it reached $23.88 per barrel.

While a greater demand for oil would generally provide pressure for an increase in oil prices, such prices are now significantly affected by the production policies of the major oil-producing nations. Thus, prices might possibly drop to relatively low levels before heightened demand would cause them to increase. Many producers, drilling contractors, and others dependent upon the oil industry might not be able to survive while waiting for the price to rebound.

By imposing taxes solely on imported petroleum, both of the bills being considered by this Subcommittee would generally increase the prices of domestic energy and refined products above the prevailing world prices. Because the prices of all energy sources are to some extent interrelated, the prices of other domestic energy sources would be increased. Thus, the effects to the domestic energy industry that are caused by falling oil prices would be relieved by each proposal. Moreover, the higher price for domestic resources may encourage exploration and development in this country or, at the least, stem the reduction in such activities resulting from lower prices.

General Impact on Business and Industry. The imposition of a tax on imported petroleum would have several clearly delineated effects on non-energy domestic businesses and industries. The increase in energy costs resulting from the tax would obviously have the most serious impact on industries that are heavy energy users or that rely significantly on petroleum feedstocks. In particular, domestic manufacturers of products such as plastic, glass, cement, paper, limestone, steel, textiles, aluminum, chemicals, and paint would face substantially higher costs. The agriculture sector, particularly farmers, also would be especially hurt, because the likely decrease in the costs of fuel and fertilizer resulting from falling world oil prices would be partially or fully offset by the imposition of an oil import fee.

In addition to the direct impact that higher energy costs would have on most domestic industries, an oil import fee also would make it more difficult for many domestic industries to sell their products abroad. Exports from the United States would face tougher competition because foreign producers of comparable goods would benefit from falling energy costs at the same time that the import fee would be maintaining U.S. energy prices at a relatively higher level. Indeed, many of the industries that would be most affected by higher energy costs have previously complained about the relatively low energy costs enjoyed by some foreign competitors. Moreover, the impact of an oil import fee on the international competitiveness of many industries would be exacerbated by an increase in imports of energy-intensive manufactured products, which would continue to enjoy the benefit of lower foreign energy costs.

Each of the effects described above would offset the reduced imports of foreign crude oil and refined products that would result from imposition of an import fee. Accordingly, imposition of an oil import fee ultimately could negatively affect our balance of trade.

Even if an exemption from the tax were provided for crude oil or refined petroleum products imported to manufacture goods destined for export, as contemplated in varying degree by S. 1507 and S. 1997, it is likely that the relief would be effective in only a limited number of cases, and that the international competitiveness of many industries would, nevertheless, be negatively affected by an oil import fee. In particular, an exemption would probably effectively benefit only vertically integrated producers that directly import petroleum for use in the manufacture of exports. The benefit of such an exemption would be of limited effectiveness, at best, for the many independent producers of intermediate and final products. Finally, imposition of an oil import fee would likely hurt independent marketers of petroleum, who cannot rely on increased production income to offset the reduced demand for their products that an oil import fee would likely entail.

Although the effects of an oil import fee on domestic industry would in general be negative, such a fee would aid several energy-producing areas. As discussed in the context of national security, imposition of an import fee would significantly benefit certain sectors of the domestic energy industry. An oil import fee also could have a major effect on the domestic refining industry. Due largely to declines in U.S. petroleum consumption and decontrol of oil prices, we have faced recently a reduction in U.S. operating refining capacity. 12/ Although domestic refiners, like all purchasers of oil, would face the higher energy costs resulting from an oil import fee, they would benefit from a structure that imposes a higher fee on refined products than on crude oil and thus discourages the importation of refined products. In this regard, it should be noted that S. 1507 and S. 1997 in different respects would both establish a higher fee on imported refined products than on imported crude oil. Accordingly, both of those proposals would aid domestic refiners.

In addition, we recognize that oil royalties, severance taxes, and other energy-related receipts are a significant source of revenue for some States. Consequently, the fiscal health of these States, which has been hurt by the steep decline in oil prices, would be improved through imposition of an oil import fee. Rapidly falling oil prices also may have an adverse impact

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12/ Data compiled by the Energy Information Administration indicate that U.S. operable refinery capacity has declined from 18.62 million barrels per year on January 1, 1981, to 15.7 million barrels on January 1, 1985. This capacity did not decline further during 1985.

on banks that have made energy loans. Many of these banks have recently made provisions for additional loan loss reserves and have reduced their volume of new energy loans. Nevertheless, continued instability in oil prices may have more serious effects on such banks, and could trigger some bank failures. By softening the fall of domestic energy prices, an oil import fee would protect those banks from declines in market prices. This beneficial effect may be offset, however, because other banks may be helped by falling oil prices and certain banks with loans to oil-exporting nations may be hurt by imposition of an oil import fee.

Effects on Energy Consumption. Higher energy costs have encouraged greater energy conservation. Some of these conservation efforts have resulted in the development of more fuel-efficient cars and appliances, and the design and installation of more energy-efficient industrial facilities. While these developments are likely to represent more permanent changes, a number of other conservation efforts, such as the installation of greater insulation in older homes and the willingness to tolerate lower winter or higher summer temperatures by adjusting thermostats, may well be dissipated by a drop in energy costs.

Policies that raise the prices of energy for consumers, such as an oil import fee, would encourage the continuation of these efforts and would deter energy use. This would be a step toward further reducing our reliance on uncertain foreign supplies.

Effect on Consumers. It is extremely difficult to determine precisely how higher energy costs resulting from a tax on imported petroleum would be distributed throughout the economy. To some extent, these costs would be shared by foreign oil producers and refiners, domestic businesses that use energy, and consumers. While tracing the precise incidence of these costs is difficult, consumers would clearly be directly and adversely affected by higher energy prices through purchases of gasoline and, depending upon the scope and effectiveness of any exemptions, home heating oil and electricity generated by burning residual fuel oil. Moreover, because prices for almost all sources of energy are interrelated and depend to a great extent on the prevailing price of oil, consumers would face increased costs through purchases of other sources of energy, including natural gas and, to a lesser extent, electricity generated by burning coal or natural gas. In addition, consumers would indirectly bear higher costs in their purchases of all goods and services, because the higher energy costs that would be faced by producers of energy-intensive basic materials and by the construction and transportation industries would, in turn, be reflected in higher prices generally.

While the effects described above would occur in the case of most consumption-based taxes, their nature is altered in the case of an oil import fee, because the Treasury would realize an increase in revenue only with respect to oil imports, while consumers would bear higher prices on all petroleum products and natural gas (and other goods), regardless of whether the oil, natural gas, or refined product was produced in the United States or abroad. Thus, while the burden of the tax would fall upon foreign producers and domestic consumers, the benefits would be shared by the Federal government and the domestic oil industry. In general, our analysis indicates that, based solely on the increase in oil prices, the domestic oil industry would realize after-tax benefits equal to $1.75 for every $1 of tax collected by the Treasury. 13/ To the extent that higher oil prices also lead to higher prices for natural gas and coal, the energy industry would realize an even greater share of the benefit in proportion to Federal revenue.

Distributional Impact. The Administration has proposed that, to the greatest extent possible, the distribution by income class of taxes paid should generally be the same following tax reform as under current law. Moreover, we have proposed that the tax system should not be an additional burden on those below the poverty line, and that such poor families should, insofar as possible, totally escape Federal income taxation. We also have sought to reduce the tax burden on middle-income working Americans. Accordingly, we must carefully evaluate the distributional impact of an oil import fee when considering the advisability of such a tax.

Lower income families spend a relatively large portion of their income on energy consumption. Families with incomes below $12,000, for example, spend approximately 25 percent of their

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13/ The allocation of the benefits of an oil import fee could be partially shifted away from domestic producers by enactment of an alternative windfall profit tax. Such a tax, which would apply to domestic oil, would withhold from the oil industry a portion of the increase in the price of domestic oil that would result from an import fee, by assuring that all oil producers would pay some excise tax with respect to the increased price of oil, and would thus shift more of the benefit to the Federal government. An alternative windfall tax also would permit the import fee to be set at lower rates, and still raise the same aggregate revenue. An alternative windfall profit tax equal to 50 percent of the oil import fee, for example, would provide an approximately equal split of the benefit between the Federal government and the domestic oil industry.

incomes on gasoline, fuel, and other energy uses, while families with incomes above $42,000 spend less than seven percent of their incomes on such expenditures. Consequently, any energy tax tends to be regressive in effect, taking a relatively greater share of income from the poor and middle class. The higher energy costs resulting from energy taxes also may lead to higher prices for other consumer goods, thus intensifying this burden on the poor and middle class, although possibly reducing slightly the regressive effect of such taxes.

The distributional impact of oil import fees, depending upon the scope and effectiveness of any exemptions, can be extremely regressive. As detailed in Table 1, for example, we estimate that the $5 and $10 per barrel tariffs imposed by S. 1507, ignoring the exemption provided for home heating fuel, would in 1989 increase energy costs for families with incomes below $10,000 by an average of 2.47 percent of total income. In contrast, the energy costs for families with incomes above $100,000 would increase by an average of only 0.20 percent of total income. When the exemption provided by S. 1507 for home heating fuel is considered, the regressive effect of the tax is curtailed, but the energy costs paid by lower income families would still increase by an average of 1.92 percent of income, while the energy costs of the higher income families would increase by only 0.18 percent. Perhaps more significantly, the increased burden of energy costs resulting from imposition of an oil import fee, as set forth in the Table 1, would for most families more than offset the tax decreases that are provided in the President's tax reform proposals. The impact of S. 1997, as illustrated in Table 2, is also regressive.

The regressive nature of a tax on imported oil and refined products may be corrected through several possible means in addition to the varying exemptions for home heating fuel proposed by the bills. First, the income tax rate schedules could be modified to reduce the taxes paid by those in the income classes that are most seriously hurt by the oil import fee. This solution, however, would substantially reduce aggregate income tax revenues, thus making enactment of a revenue-neutral tax reform bill more difficult. Moreover, an adjustment to the rate schedules would not help many of the families that are most negatively affected by an oil import fee, namely those who already do not face any income tax liability and those who will be removed from the tax rolls by virtue of tax reform.

Second, consideration could be given to targeting relief narrowly to the additional burden faced by lower income families. In particular, imposition of an oil import fee could be accompanied by enactment of a refundable income tax credit directed at lower income families. Although a refundable credit might be difficult to design satisfactorily and would undoubtedly pose substantial administrative problems, such a credit could be used to reduce the regressive nature of an energy tax at a relatively moderate revenue cost.

Regional Impact. An oil import fee would have a disproportionate impact on certain regions of the United States that consume more energy or different types of energy than other areas. As illustrated by Table 3, the consumption of energy varies significantly by region. Families in the Northeast, for example, consume more energy than do families in other regions. In addition, because the various regions differ in population density and availability of public transportation, they also differ in their use of motor fuels. For example, gasoline consumption is regionally dependent, and tends to be higher in areas outside the Northeast. Finally, the types of fuels used in different regions vary, and those differences contribute to a non-uniform regional impact of an oil import fee.

As suggested by the levels of energy expenditures set forth in Table 3, the burden of an oil import fee, imposed without any exception, would be felt most heavily in the Northeast. Both proposals being considered by the Subcommittee mitigate this disproportionate regional impact by providing exemptions for heating fuel and, in the case of S. 1507, crude oil, that is to be refined into home heating fuel. This solution, while in concept a well-intentioned response, raises several concerns.

Exemptions for petroleum used for specific purposes are difficult to administer effectively, will impose bureaucratic burdens on segments of the domestic oil industry, and may offer only limited relief to the affected people. For example, if an exemption were granted only to home heating fuel, as proposed by S. 1997, a powerful incentive would be created to increase imports of home heating fuel, thus hurting domestic refineries. If this effect were avoided by extending the exemption to crude oil imported for use in refining home heating fuel, as proposed by S. 1507, the exemption would be more effective in shielding the cost of home heating oil from a price increase. The potential revenue increase resulting from imposition of the import fee, however, would be reduced considerably. In particular, we estimate that an exemption granted to both crude oil and refined home heating fuel, such as the one proposed by S. 1507, would reduce the revenue gained through an import fee by approximately 15 percent.

More significantly, however, the task of monitoring the ultimate use of refined products produced from imported crude oil would be extremely onerous. Such a task is particularly difficult, because home heating fuel is used for commercial heating and also is virtually identical to diesel fuel, uses that would not enjoy any special exemptions under either bill. Finally, we should not underestimate the potential bureaucratic and regulatory burdens that the administration of such exemptions might place on domestic producers, refiners, and heating oil distributors.

The burden of increased residential electric bills, caused by the higher costs of residual fuel oil and natural gas used to generate electricity, that would result from an oil import fee also falls disproportionately on the Northeast. Similarly, natural gas prices would increase sympathetically with

higher oil prices. The increased cost of heating homes with electricity or natural gas, however, is not addressed in either bill. In addition, California would be especially affected by such a fee, because of its dependence upon oil-generated electricity. A scheme of exemptions for residual fuel designed to correct this impact would lead to greater revenue losses and more administrative problems and bureaucratic burdens than would be created by an exemption for home heating fuel.

Foreign Policy Considerations. Any proposal to impose a fee on imported crude oil and refined petroleum products raises a host of foreign policy concerns. As discussed below, the imposition of an oil import fee, depending upon its provisions, would raise concerns under the General Agreement on Tariffs and Trade (GATT) and bilateral agreements with several oil-exporting countries. In addition, an import fee, by increasing the price of imported oil and refined petroleum products, would decrease U.S. demand for such oil, and would thus reduce the volume of exports for many countries, some of which are heavily dependent upon revenues from such sales to meet foreign loan obligations. While the effects of such a decrease would vary depending upon the country, it would especially hurt several of our most established trading partners, including Mexico, Canada, Venezuela, and the United Kingdom, each of which supplies a significant portion of our petroleum imports. While exemptions for oil imported from one or more particular countries could be provided to mitigate these consequences, such exemptions would not only raise the treaty concerns discussed below, but also would pose even greater administrative and bureaucratic burdens than an exemption for home heating fuel or other specific uses. Moreover, such exemptions, depending upon the countries involved, could significantly affect the potential revenue raised by an oil import fee. 14/

Administrative Burdens. As noted above, we are concerned that the proposals for various exemptions contained in both bills would lead to substantial administrative and bureaucratic burdens. In particular, providing exemptions for crude oil or refined products imported from particular countries or for particular uses might necessitate an extensive regulatory and enforcement apparatus. Such regulation could amount to unreasonable Federal government intrusion into the oil business, a role we properly abandoned with the removal of oil price controls in 1981.

14/ Based on current import levels, if an exemption were provided for crude oil and refined petroleum products imported from Mexico, we estimate a 17 percent reduction in the revenue potentially raised by any of the proposals. If exemptions were provided for Canada, Venezuela, or the United Kingdom, we estimate that the revenue would be decreased by 15 percent, 12 percent, and six percent, respectively. Moreover, we note that granting an unlimited exemption for oil imported from certain countries may result in an increase in imports from those countries, thereby magnifying the potential reductions in revenues.

<u>Effect of GATT and Other Treaty Issues</u>. We are reviewing whether the various oil import fee proposals are consistent with our treaty obligations under the General Agreement on Tariffs and Trade (the "GATT") and various other bilateral agreements. We have committed ourselves in the GATT not to increase our tariffs on refined petroleum products. 15/ Both of the oil import fees under consideration would violate these commitments unless one of the GATT exceptions applies. One such exception is national security. We are considering whether, under current conditions, an import fee can be justified as necessary, in GATT terms, for the protection of "essential security interests."

The GATT generally allows other countries to "redress the balance of concessions" if one country imposes new import barriers, even if those restrictions are permissible under the GATT exceptions. If GATT signatories harmed by the oil import fee were to redress the balance of concessions by imposing offsetting duties on U.S. products, this would harm U.S. producers of such products. One way to avoid other countries redressing the balance by retaliation would be to offer them "compensation" by reducing U.S. trade barriers to other products such countries export to the United States. However, providing compensation by reducing U.S. trade barriers to other products from injured countries would adversely affect U.S. producers of competing products. Compensation would also reduce the net revenue raised from any oil import fee.

If the import fee were applied on a discriminatory basis, such as exempting certain suppliers, it would also violate the non-discrimination obligation in the GATT generally known as the most favored nation provision. Various bilateral Friendship, Commerce and Navigation Treaties, including treaties with some oil producing countries that are not GATT signatories, contain similar most favored nation provisions. Excepting some suppliers from any oil import fee would be likely to draw a response from those suppliers entitled to most favored nation treatment that are not excepted. Before deciding on any oil import fee, we should carefully consider U.S. treaty obligations and the adverse effect any breach of such obligations would have on U.S. producers.

15/ We have made a similar commitment to Venezuela with respect to crude oil in a bilateral treaty. The most favored nation provision in the GATT, discussed below, would preclude the United States from imposing higher duties on GATT signatories than on Venezuela.

<u>Macroeconomic Effects</u>. As an oil-importing nation, the United States stands to benefit from the decline in world oil prices. The present decline, if sustained, will likely result in a short-term reduction in the inflation rate and a longer-term reduction in interest rates. The decline in world oil prices is expected to result directly in lower prices for both refined oil products and other fuels. In addition, the cost of many energy-intensive goods, ranging from steel and other metals to glass, ceramic, and plastic products, also would be expected to decline. These macroeconomic benefits resulting from lower oil prices would be diluted if an oil import fee were imposed.

An oil import fee would clearly affect the relative price of goods and services, but the extent of its impact on the overall price level and interest rates would depend, in part, on the response of the Federal Reserve. If the money supply were allowed to increase to accommodate the fee, there would be a short-term increase in the inflation rate, thus offsetting the price reductions that would otherwise result from lower world oil prices. 16/ If the money supply were held steady, however, there would likely be a reduction in labor and capital income. In short, depending upon monetary policy, one might expect either higher prices and a slight decline in real GNP or more stable prices and greater decline in real GNP.

Conclusion

As I have indicated throughout my testimony, there are both benefits and detriments that would result from the imposition of an oil import fee as proposed in S. 1507 and S. 1997. The President has stated that he would not foreclose consideration of an oil import fee in the context of a revenue-neutral tax reform bill that meets his prerequisites.

16/ In addition to its more general effects, the inflationary impact of the oil import fee, if any, might also lead to increased Federal outlays for various entitlement programs that are affected by the Consumer Price Index (CPI) and for interest payments on the national debt. Although it is difficult to determine the precise impact that an oil import fee would have on the CPI, we note that a reduction in the CPI of one percentage point could result in a $4 billion saving in Federal outlays.

Table 1

Average Per-Family Burden for The Boren-Bentsen Bill (S. 1507), for 1989, Assuming Oil Prices $4 per barrel less than CEA Projections.

Family Income ($ thousands)	Increase in Oil Expenditures (in dollars) 1/				Increase in Expenditures as Percent of Family Income 2/	
	Electricity	Fuel Oil&LPG	Gasoline	Total	No Exemptions	As proposed
0-10	6.56	27.72	89.33	123.62	2.47	1.92
10-15	8.89	28.13	129.62	166.64	1.33	1.11
15-20	9.81	23.36	154.19	187.37	1.07	.94
20-30	10.53	25.61	186.58	222.72	.89	.79
30-50	14.30	32.35	241.95	288.60	.72	.64
50-100	19.06	39.53	309.45	368.04	.49	.44
100 or more	27.11	59.23	319.51	400.85	.20	.18
U.S. Average	12.23	35.10	196.49	287.77		

Family Income ($ thou.)	Percentage Change in Tax Under President's Proposal	Increase in Expenditures as % of Current Tax		Total % Change In Tax Burden	
		No Exempt.	As proposed	No Exempt.	As Proposed
0-10	-35.5	177.6	137.0	141.1	101.5
10-15	-22.8	41.7	34.6	18.9	11.8
15-20	-13.5	23.3	20.4	9.8	6.9
20-30	-8.7	14.4	12.5	5.4	3.8
30-50	-6.6	9.3	8.2	2.7	1.6
50-100	-4.2	5.2	4.7	1.0	.5
100 or more	-5.3	1.5	1.4	-3.8	-3.9

Office of the Secretary of the Treasury
Office of Tax Analysis

February 26, 1986

1/ Assumes that foreign and domestic producers absorb $1 per barrel of the fee. Does not include increased price of natural gas or non-oil goods.

2/ Does not include possible increase in transfer payments.

Table 2

Average Per-Family Burden for The Wallop-Bentsen Bill (S. 1997), for 1989, Assuming Oil Prices $4 per barrel less than CEA Projections.

Family Income ($ thousands)	Increase in Oil Expenditures (in dollars) 1/				Increase in Expenditures as Percent of Family Income 2/	
	Elec-tricity	Fuel Oil&LPG	Gaso-line	Total	No Exemptions	As proposed
0-10	9.84	41.59	134.00	185.43	3.71	2.88
10-15	13.34	42.19	194.44	249.96	2.00	1.66
115-20	14.72	35.04	231.29	281.05	1.61	1.41
20-30	15.80	38.41	279.87	334.09	1.34	1.18
30-50	21.44	48.52	362.93	432.90	1.08	.96
50-100	28.58	59.29	464.18	552.06	.74	.66
100 or more	40.67	81.34	479.26	601.26	.30	.26
U.S. Average	18.35	52.64	294.29	365.27		

Family Income ($ thou.)	Percentage Change in Tax Under President's Proposal	Import Fee Burden as % of Current Tax		Total % Change In Tax Burden	
		No Exempt.	As proposed	No Exempt.	As Proposed
0-10	-35.5	264.9	205.5	229.4	170.0
10-15	-22.8	62.5	51.9	39.7	29.1
15-20	-13.5	34.9	30.6	21.4	17.1
20-30	-8.7	21.2	18.8	12.5	10.1
30-50	-6.6	13.9	12.3	7.3	5.7
50-100	-4.2	7.8	7.0	3.6	2.8
100 or more	-5.3	2.3	2.0	-3.0	-3.3

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February 26, 1986

1/ Assumes that foreign and domestic producers absorb $1 per barrel of the fee. Does not include increased price of natural gas or non-oil goods.

2/ Does not include possible increase in transfer payments.

Table 3

Per-Family 1983 Household Energy Expenditures by Region (in dollars).

Region	Natural Gas	Electricity	Fuel Oil, LPG	Gasoline	Total
Northeast	400.00	577.78	388.89	972.22	2,338.89
Midwest	431.92	525.82	103.29	1,126.76	2,187.79
South	224.20	697.51	92.53	1,209.96	2,224.20
West	260.61	430.30	42.42	1,181.82	1,915.15
Average U.S.	323.78	578.26	146.95	1,136.20	2,185.19

Source: Energy Information Administration

TREASURY NEWS

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

FOR IMMEDIATE RELEASE February 26, 1986

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RESULTS OF AUCTION OF 5-YEAR 2-MONTH NOTES

The Department of the Treasury has accepted $7,520 million of $19,156 million of tenders received from the public for the 5-year 2-month notes, Series J-1991, auctioned today. The notes will be issued March 5, 1986, and mature May 15, 1991.

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

	Yield	Price
Low	8.10%	100.043
High	8.13%	99.918
Average	8.12%	99.960

Tenders at the high yield were allotted 43%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

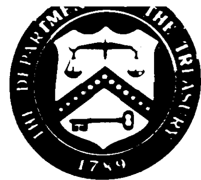
Location	Received	Accepted
Boston	$ 10,143	$ 10,143
New York	16,502,071	6,533,338
Philadelphia	6,000	6,000
Cleveland	147,005	81,930
Richmond	47,337	17,637
Atlanta	32,979	25,409
Chicago	1,460,961	581,211
St. Louis	80,768	63,768
Minneapolis	17,134	15,994
Kansas City	44,787	44,287
Dallas	10,909	9,769
San Francisco	795,391	129,691
Treasury	726	726
Totals	$19,156,211	$7,519,903

The $7,520 million of accepted tenders includes $450 million of noncompetitive tenders and $7,070 million of competitive tenders from the public.

In addition to the $7,520 million of tenders accepted in the auction process, $318 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities.

B-486

TREASURY NEWS



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FOR IMMEDIATE RELEASE March 3, 1986

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RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,857 million of 13-week bills and for $6,812 million of 26-week bills, both to be issued on March 6, 1986, were accepted today.

DEPARTMENT OF THE TREASURY

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 5, 1986			26-week bills maturing September 4, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	6.92% a/	7.14%	98.251	6.86%	7.20%	96.532
High	6.92%	7.14%	98.251	6.88%	7.23%	96.522
Average	6.92%	7.14%	98.251	6.87%	7.22%	96.527

a/ Excepting 1 tender of $10,000,000.

Tenders at the high discount rate for the 13-week bills were allotted 59%.
Tenders at the high discount rate for the 26-week bills were allotted 5%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 41,840	$ 41,840	$ 46,295	$ 46,295
New York	28,325,485	5,974,615	19,954,000	5,983,405
Philadelphia	22,200	22,200	18,490	18,490
Cleveland	70,570	44,800	35,800	35,800
Richmond	45,470	45,470	87,960	47,010
Atlanta	59,055	58,055	59,515	39,265
Chicago	1,282,850	81,850	1,394,525	77,025
St. Louis	91,685	55,185	82,945	50,195
Minneapolis	40,275	14,675	43,115	18,115
Kansas City	63,875	60,775	49,075	49,075
Dallas	51,340	41,340	34,030	28,030
San Francisco	1,339,085	83,260	864,410	71,210
Treasury	333,300	333,300	347,685	347,685
TOTALS	$31,767,030	$6,857,365	$23,017,845	$6,811,600
Type				
Competitive	$28,695,665	$3,786,000	$19,399,735	$3,193,490
Noncompetitive	1,149,665	1,149,665	983,810	983,810
Subtotal, Public	$29,845,330	$4,935,665	$20,383,545	$4,177,300
Federal Reserve	1,748,900	1,748,900	1,650,000	1,650,000
Foreign Official Institutions	172,800	172,800	984,300	984,300
TOTALS	$31,767,030	$6,857,365	$23,017,845	$6,811,600

1/ Equivalent coupon-issue yield.

B-487

STATE DEPARTMENT PRESS RELEASE

FOR IMMEDIATE RELEASE

U.S. and Barbados Exchange Instruments of Ratification of Bilateral Tax Convention

On February 28, 1986, the United States and Barbados exchanged instruments of ratification of a bilateral convention to avoid double taxation on income and to prevent tax evasion, thus bringing the Convention into force. It is the first income tax treaty concluded between the U.S. and Barbados.

At a ceremony held in the Department of State, Barbados Ambassador Peter D. Laurie and Deputy Assistant Secretary of State Richard N. Holwill signed and exchanged instruments of ratification of the Convention between the United States and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Income, together with an exchange of notes, signed at Bridgetown on December 31, 1984. The Convention will enter into force immediately, and certain provisions will have retroactive effect for both governments.

The Convention's principal features include provisions to prevent third-country residents from taking unwarranted advantage of treaty benefits, and establishes maximum rates of tax at source on payments of dividends, interest and royalties. It contains rules found in most U.S. tax treaties regarding taxation of business profits, personal service income, transportation income, real property income and capital gains, as well as relief from double taxation. The Convention recognizes that Barbados is a developing country by providing somewhat broader rights for the source country to tax business profits and certain types of personal income than is generally true for U.S. tax treaties with developed countries. The Convention also contains rules concerning resolution of disputes and the exchange of tax information.

Barbados is a Caribbean Basin Initiative beneficiary, and signed a Tax Information Exchange Agreement with the United States in September, 1984.

TREASURY NEWS

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DEPARTMENT OF THE TREASURY

FOR RELEASE UPON DELIVERY
Expected at 9:30 a.m.
March 4, 1986

TESTIMONY OF THE HONORABLE
GEORGE D. GOULD
UNDER SECRETARY FOR FINANCE
U.S. DEPARTMENT OF TREASURY
BEFORE THE SENATE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS
TUESDAY, MARCH 4, 1986

Mr. Chairman and Members of the Distinguished Committee:

I greatly appreciate this opportunity to appear before your Committee. You have faced numerous significant financial issues over the past few years, and I believe you have striven to keep the legal and regulatory structure in step with a rapidly evolving marketplace. That challenge is still present today, perhaps more than ever. I am pleased to have a chance to work with this Committee, and perhaps to contribute to its important deliberations. While I have had some opportunity to meet many of this Committee's members individually, I look forward to getting to know all of you soon.

My testimony addresses three topics. First, I would like to say a few words about the prospects of the nation's insured depository institutions and their ability to serve consumers, businesses, and themselves. Second, I will discuss the problems of thrifts and FSLIC, and offer some suggestions on how we might cope with them better. Third, my testimony touches on some other deposit insurance issues -- related specifically to how we might increase the fairness and effectiveness of the FDIC's operations.

I also am pleased to note that my colleagues and I have attempted to offer this Committee complementary statements. Comptroller Clarke will expand on my remarks about banks' abilities to serve the public and maintain financial health. Later this month, Chairman Seidman will share some more detailed ideas about strengthening deposit insurance operations. And we have been working closely with Chairman Gray to develop some practical solutions to help FSLIC.

I. Services to the Public and Profitability: The Keys to Safety and Soundness

A. Banks' Changing Marketplace

Any deposit insurance system can be only as strong over time as the industry it is indirectly insuring. And an industry can remain financially healthy only if it can compete effectively to serve consumers and other customers.

In the past, banks competed among themselves in a special business preserve created by the law. Neither technology nor changing customer demands posed a real threat. Dissatisfaction with service was communicated through Congress or the regulators as much as through the market.

Those days are gone. And they should be. The price for the banks' security was paid for by consumers, who had ceilings on savings rates and limited investment options; by businesses, many of which were forced to raise funds through less efficient banking intermediaries; and by society, which made saving less attractive and restricted the development of investment instruments that reduce and spread risks.

There are many beneficiaries of the new era -- consumers, small savers, business borrowers, and our international competitive position in a critical service industry. But even if one were willing to sacrifice the interests of these groups in order to turn the clock back for banks, the deed could not be done. The marketplace, technology, and consumer preferences have moved ahead. The big problem today is that banks are falling behind, with a possible consequence for safety and soundness in the not-too-distant future.

Let me offer a few examples.

On the asset side, the growth and diversification of securities stand out as a major competitive challenge to the depositories' loan portfolio business. Many hitherto illiquid loans -- mortgages, commercial paper, even car and other consumer loans -- are now "securitized." These securities offer low-cost, risk-diversified, high-return vehicles for transferring funds from savers to spenders and investors.

The whys and wherefores of this evolution are too detailed to discuss at length in this statement. In brief, advances in computers and communications have made "packaged" transactions and investments less expensive, more flexible, and more available. Investors can acquire more detailed information about the characteristics and risk profiles of myriad investment opportunities -- without relying on banks to "intermediate" through their port-

folios. Securities can even be broken down and "rebundled" to suit special investor tastes -- for example, the collateralized mortgage obligation (CMO), which structures cash flows from mortgage securities to suit different preferences for maturity and uncertainty.

The securities' numbers and effects are as notable as their names and acronyms. In 1980, total commercial paper outstanding amounted to $124 billion while commercial banks' commercial and industrial (C&I) loans amounted to $327 billion. By 1985, commercial paper totaled $303 billion and bank C&I loans were $494 billion -- increases of 143 percent and 51 percent, respectively. Moreover, the competition from commercial paper forced banks to switch a large percentage of their C&I loans from the prime rate to the usually lower money market rates.

Dealer-placed, non-financial commercial paper is most directly comparable with bank C&I loans. The increase in outstandings for this type of commercial paper in the 1980-1985 period was 140 percent, almost three times the increase in commercial bank C&I loans over the same period. (Dealer-placed, non-financial commercial paper outstanding grew from $37 billion to $88 billion -- 11 and 18 percent of C&I loans at the end of 1980 and 1985, respectively.)

Mortgage-backed securities supply another example of the remarkable transformation of illiquid assets into easily traded securities. From modest beginnings in the early 1970's, outstanding mortgage-backed securities of various kinds now total about $375 billion.

Changes on the liability, or deposit, side of the banking business are just as striking. The well-known money market funds took advantage of much lower cost organizations to offer savers a higher return. In part because the Congress passed the Depository Institutions Deregulation and Garn-St Germain Acts, banks have been able to counter the money market funds to a degree. (Nevertheless, between 1980 and 1985, consumer deposits in commercial banks increased by 85 percent while the non-institutional holdings of money market funds increased by over 250 percent.)

Money market funds were just the first shot in the struggle for savers' money. And any perusal of investment advertisements in today's papers reveals that bank investments are the stragglers. The Wall Street Journal's "Business Bulletin" of February 20 led off with the alert that "Banks Scramble for IRA dollars as interest rates decline": This report and others explain that bank and thrift CD's are losing the contest for middle class savings to mutual funds. Meanwhile, Federal district courts disagree over whether banks can offer competitive collective retirement trust accounts.

If banks cannot evolve, the term "counting house" industry may before long become an epitaph like "smoke stack" or "rust bowl." This trend is understandably hard for most of us to accept, schooled as we have been by banking's historical image of affluence and influence. We see some quarterly profits that look reasonable. But the indicators of longer-term expectations about returns on banks' equity are difficult to ignore.

Mr. James McCormick, in testimony before this Committee last year, contended that relative financial performance of major banks has been slipping for about 15 years, as measured by a capital asset pricing model. While bank stocks have moved up with other stocks since the time of that testimony, Mr. McCormick's basic findings about major banks' relative financial performance still appear sound. Poor performance means banks will have a harder time attracting capital; the attempts to earn a higher return in their traditional, limited sphere of business may even increase their loan portfolio risk.

Weak banks translate into weak deposit insurance funds. Such weakness also means that we are wasting a valuable and vital business that can help consumers, small savers, American industry, and our international competitiveness. Economists call them "end-users," but banks call them customers. Banks are trying to adapt, straining to offer more and better services. Appropriately enough, they are seeking different niches -- depending on their size, location, experience, and comparative advantage. But their common problem is that they are hemmed in by out-of-date legal constraints.

I urge the Congress to reconsider and clarify the services that banking organizations may offer their customers. This is not just a matter of competitive equity, but one of competitive survival. If bank holding companies' authority to compete in familiar business areas such as commercial paper, mutual funds, municipal revenue bonds, and mortgage-backed securities is not clarified soon, they run the risk of being bypassed permanently.

Banks' prospects are looking even worse in light of recent court decisions about commercial paper services. Unless reversed by the courts or the Congress, these decisions would force banks to give up business they have handled for years. This retrogression would hurt both business customers and investors.

Small banking organizations in particular need the freedom to aid consumers and to help themselves by offering insurance, real estate brokerage, and other local services. Banks have been shut off from these activities not because of risk, but because powerful interest groups want to preclude competition. Moreover, the whole of the benefits for savers exceeds the competitive gain from the sum of individual services: If banking organizations can diversify, they can offer integrated financial planning to savers who cannot afford expensive investment advisors.

If the Congress does not wish to deal specifically with each new line of business for banks, it could permit the Federal Reserve Board to authorize bank holding company "activities of a financial nature," with whatever limits the Congress considers appropriate. And it is certainly hard to understand why the Congress should not at least grant banking organizations the authority to sponsor mutual funds that would be available for middle class savings -- so small savers can benefit from their competitive service.

B. Consumer Banks

Some people who are concerned about the financial future of depositories have determined the best course is to sacrifice the consumer, or other users of bank services. They seek to hold back new entrants and competitors from the bank and thrift industries. One can understand this approach, especially from those used to the system that prevailed before communications-computer technology and consumer-saver preferences opened up the marketplace.

Nevertheless, it is a mistaken approach for anyone concerned about services to the public. Moreover, I fear it could be a dangerous course from a safety and soundness perspective -- because we would waste energy trying to hold back the rising waters instead of seeking to channel them toward prudent and productive uses.

The so-called nonbank bank is perhaps the prime example of this challenge. Even the name, along with its accessory "loophole," is designed to evoke opposition. One wonders what would have been the future of discount brokers if some public affairs genius for securities firms had tarred them effectively with the term "nonbroker broker."

I cannot discover anything wrong with a bank that orients its business toward consumers. Indeed, it can bring additional capital, skills, competition, and perhaps retailing expertise to the banking system. Some noteworthy groups have moved past the labels to come to the same conclusion: For example, the American Association of Retired Persons has announced its support for a form of nonbank bank.

Like other primarily middle class groups, senior citizens want to be smart investors, but they struggle to understand the diversity of available products. Why should we stop firms from focusing their business expertise on meeting this need?

Small businesses, too, can be served well by the nonbank bank, albeit in different form: the kind of bank that foregoes demand deposits but offers commercial loans. These lenders are serving as conduits between the large deposit and commercial paper mar-

kets, and businesses that are not big enough to issue securities. It is, of course, important to examine how these new banks will be regulated and supervised. The first answer, contrary to the statements of some, is that consumer banks are chartered and regulated by state and national banking authorities -- just like all other banks. Indeed, a "family bank" bill that has been introduced would subject them to more stringent community service and capital requirements than banks and thrifts face.

It is also important to ask about the regulation of transactions and affiliations between the consumer bank and its parent. A concern for the safety of the bank payments system may merit requiring certain commitments by the parent firm, or structural intermediaries between parent and bank. The blunt approach to this task is simply to prohibit nonbank banks altogether. But then we have lost the many benefits of these new entrants. Moreover, the prohibition approach runs the sizable risk of failing to hold back market change and thus missing an opportunity to develop the right regulation from the start.

There already are a number of laws that govern the relations between nonbank banks and their parents. The Treasury Department would certainly welcome, however, a charge by the Congress to work with the financial institutions regulators to develop uniform rules on the affiliations between nonbank banks and their parents.

My closing comment on consumer banks relates to thrifts. As I discuss below, one way to reduce the size of the problem borne by the thrift industry and FSLIC involves permitting more firms to purchase ailing thrifts. Currently, some laws, Federal Reserve Board policies, industry opposition, and pending legislation have stymied would-be purchasers. Some rejected firms that want to offer financial services have formed consumer banks.

Congress may wish to consider reducing the barriers encountered by these potential acquirers -- thereby channeling potential consumer bank entrants toward thrifts, reducing FSLIC's costs (and the S&L industry's ultimate burden), and bringing new capital into the industry. Without a significant Congressional effort, however, we could end up cutting off valuable new providers of services to middle class consumers and not help thrifts.

II. The Problems of the Thrifts and FSLIC

I recognize that for many people the problems of the thrifts and FSLIC comprise the most important deposit insurance issue. The Administration shares this interest in addressing the thrift industry's problems in a prompt fashion. Indeed, given

the decline in interest rates and the current substantial profits of many thrifts, this is a propitious time to make headway. Today, I would like to report to you on: (1) estimates of the size of the problem; (2) the limits of FSLIC's current resources; and (3) a suggested approach toward solving these problems.

A. Problem Size

Anyone's estimate of the cost of resolving problem thrift cases entails considerable uncertainty. The hesitation is partially attributable to important variables -- such as interest rates and regional real estate conditions -- that may affect significantly the health of many institutions over time. In addition, Congress and the FHLBB have the option of permitting many institutions that are liquid but technically insolvent to remain open.

The most common method of calculating the set of problem institutions is through net worth analysis, which is based on an examination of a thrift's capital. There are various ways to measure a thrift's capital base, but the two most prevalent approaches rely on GAAP (Generally Accepted Accounting Principles) and RAP (Regulatory Accounting Principles, which include special adjustments that increase capital).

As of September 30, 1985, there were 461 GAAP-insolvent thrifts insured by FSLIC. These thrifts had assets with a book value of $114 billion; 236 of them were unprofitable in the third quarter.

As of the same date, there were 105 RAP-insolvent thrifts insured by FSLIC. Their assets totaled $22 billion, and only four had net income in the third quarter.

The table attached to this statement gives a fuller exposition of the possible problem set. In particular, it supplies (1) statistics for a narrower net worth measure, tangible net worth (TAP), which excludes goodwill and other intangible assets, and (2) data on thrifts with net worth between 0 and 3 percent of assets.

One can refine the analysis of thrifts' financial soundness by examining factors such as quality of profits, duration match between assets and liabilities, and portfolio composition. Indeed, FSLIC employs this detail to select its case load, which currently consists of about 90 thrifts with assets of approximately $40 billion. The FHLBB's Office of Examination and Supervision also uses the financial detail from "call reports" to develop a "next tier" list of significant supervisory cases.

Moving from these statistics on troubled thrifts to identification of a number that will require FSLIC's assistance involves considerable supposition and judgment. The Bank Board, the GAO, and various academicians have published a number of analyses of potential demands on FSLIC. Under present conditions, their estimates of the number of thrifts requiring at least some direct assistance range between 200 and 460 institutions. Their estimates of the book value of assets involved runs from $60 to $120 billion.

Any estimate of resolution costs is equally indefinite. A few years ago, when "interest rate spread" cases dominated FSLIC's case load, resolution costs were about five percent or less of an institution's assets. But the surge in cases involving poor quality assets has increased that percentage considerably. Estimated resolution costs as a percentage of assets in 1985 and 1984 were about 15 percent. If asset quality cases diminish in size and number, this percentage could fall considerably.

In sum, the recently published reports estimate a range of 200-460 problem thrifts, with assets of $60-$120 billion and resolution costs between 5-20 percent. They suggest that the total cost of assistance would range from about $5-$25 billion. Chairman Gray's response to Chairman Garn earlier this year appraised the resolution costs at almost $17 billion.

FSLIC need not incur all these costs immediately. Indeed, as an organizational matter, FSLIC may need to prolong its assistance effort. Deferring the resolution of problem institutions does, however, entail risk. An increase in interest rates will cause additional losses. Without appropriate supervision, thrifts in a precarious position may take actions that increase risk and possibly ultimate loss. Even with careful supervision, FSLIC may end up assuming the operating losses from thrifts that continue to lose money. Therefore, we believe it is in FSLIC's, the industry's and the public's interest to step up both the resolution and supervision effort considerably.

B. FSLIC's Resources

FSLIC must cope both with financial and organizational constraints. The FHLBB has just reported that FSLIC's total reserves (assets minus liabilities) at the end of 1985 totaled about $6 billion. If FSLIC's "allowances for losses" for various assets are low, as some commentators have asserted, then its total reserves would be commensurately lower.

FSLIC's annual income comes from its regular deposit insurance assessments (one-twelfth of one percent of deposits), investment income, and a special assessment (at most, one-eighth of one percent annually). We estimate that FSLIC's 1986 income before expenses should total about $2.6 billion, of which a little over $1 billion is from the special assessment.

The FHLBB and FSLIC are expanding staff considerably so as to handle better their supervisory and problem case resolution responsibilities. The FHLBB's budget included 628 staff positions ("full time equivalents") in 1985; the Administration is seeking to increase this number to 862 in 1986 and 965 in 1987. The break out for FSLIC alone is 159 in 1985, 298 in 1986, and 372 in 1987.

Furthermore, during 1985 the FHLBB shifted its examination force (about 750 people) to the 12 FHLBanks, which have mapped out an ambitious growth program for this important function. The establishment of the so-called 406 Corporation, now properly focused in authority, may also help FSLIC to dispose of assets more expeditiously and profitably.

Despite these substantial efforts to expand organizationally, there are limits on FSLIC's capability to increase its case resolution efforts. In setting future targets, we need to be aware of past results: FSLIC resolved 33 cases ($6.5 billion in assets) in 1985; 27 ($6 billion in assets) in 1984; 49 ($16 billion in assets) in 1983; and 74 ($28 billion in assets) in 1982. The larger numbers in earlier years reflect the relatively easier task (and lower cost) of resolving "negative interest rate" spread cases.

C. A Suggested Approach: A Three-Pronged Strategy

We recommend a three-pronged strategy to help the thrift industry and FSLIC.

First, we need to strengthen the thrift industry as a whole. We must set targets and create incentives for the industry to increase its capital. Concurrently, we need to halt the growth of the problem through improved supervision.

Second, we must enhance FSLIC's resources so that it can handle a greater number of insolvent institutions. FSLIC needs additional funds if we wish to make more progress, more quickly. To avoid placing too great a burden on the industry at once, the funds for FSLIC should be a balance of industry assessments and prudent borrowing or investment from the Federal Home Loan Banks. In effect, FSLIC could borrow against its future stream of assessment and investment income to avoid encumbering the industry with a full recapitalization effort immediately.

Third, we can lower the resolution costs that FSLIC and the industry must pay if we manage to increase the demand from acquirers and enhance the franchise value of ailing thrifts. New entrants can also increase the industry's overall capital base and long-term health.

We recognize that interindustry thrift acquisitions are a touchy subject for many parties, especially some segments of the industry that wish to avoid competition. But the acquisition logic is straightforward and undeniable. The problem institutions have created real costs that FSLIC and the industry must bear. Neither the Congress nor the Administration is in the mood to accept a budget-busting bailout, although we can help in other non-expenditure ways. So if the thrift industry wants to cut its costs, it should not close out potential acquirers.

As I noted in the first part of this statement, these new competitors are already pursuing alternatives that will enable them to serve consumers and others. Why not channel this energy and capital to help FSLIC (and the thrift industry) instead of trying to retain the market structure of a much earlier era? Indeed, many thrifts, such as the members of the National Council of Savings Institutions, have recognized and accepted these stark facts. NCSI welcomes increased acquisitions of ailing thrifts by a variety of firms.

We also have had productive discussions with the U.S. League of Savings Institutions. While we may have some differences of opinion, we agree on a great deal. And there's a strong common interest in action now to help thrifts and strengtnen FSLIC.

We acknowledge that the thrift problem will not be solved overnight. But interest rates are down and many in the industry are enjoying exceptional profits. This is the time to move forward vigorously with the elements of this three-part program.

1. Strengthening the Thrift Industry

First, we need to increase the capital base of the industry. This increase can be spurred in part by FHLBB regulations, currently under consideration, to increase minimum net worth requirements over time. (Risk-based capital requirements offer a variation on this theme.)

To comply, some mutual thrifts may need to switch to stock form, because it will prove difficult to build the necessary capital by relying solely on retained earnings. The FHLBB is examining ways to help by easing the conversion process. Furthermore, it is appropriate to consider incentives to raise capital as well as mandates to do so; higher capital levels could be linked to increased business freedom.

Second, the FHLBB should continue its effort to phase out regulatory accounting (RAP). The industry's ability to return to generally accepted accounting principles (GAAP) would be a valuable signal to investors and depositors that this industry will be run soundly.

Third, the FHLBB and the FHLBanks should continue to enhance their efforts to improve supervision. The additional latitude in business activities that thrifts now enjoy must be combined with careful monitoring, especially for thrifts without much of their own equity capital at stake. Active enforcement of rules to limit or monitor the growth of weak and poorly capitalized thrifts should be an adjunct to this supervision. An appropriate system of risk-related insurance premiums may buttress this effort.

Fourth, we need to reconcile states' authority to grant new thrift powers with FSLIC's financial responsibility to pay up if thrifts fail. We believe some proposals go too far in the direction of prohibiting state-authorized activities. We believe a better balance could be achieved by the retention of additional state powers only in holding company subsidiaries (rather than prohibit them) -- if the Bank Board determines this extra protection of FSLIC is necessary. The state institutions could still proceed in new business areas, but they would need to do so with their own capital (through a holding company subsidiary) instead of with FSLIC-insured funds. This capital could include profits "upstreamed" from the thrift subsidiary -- if they are not necessary to meet Bank Board capital standards.

2. Enhancing FSLIC's Resources

FSLIC's estimated income before expenses for 1986 is about $2.6 billion, including a little over $1 billion from another year of the special assessment. There have been numerous suggestions about ways to raise more capital for FSLIC. The proposals include a special one percent recapitalization, an increase in the special assessment, and a merger with the FDIC. We would prefer to avoid these measures for now, if possible. Instead, we believe the current contributions to FSLIC can be combined with carefully evaluated borrowing and investments from the FHLBanks, spaced out over time.

Some members of the industry are seeking to end the special assessment. While we agree that the assessment must remain "special" and impermanent, it is not the right time to scale it back. We can review the need for this extra charge after the FHLBB has had an opportunity to address more problem cases. Indeed, if FSLIC can deal promptly with some of the weakest thrifts, which are often among the most aggressive bidders for "hot" money, the case resolution effort may be able to reduce the industry's cost of obtaining deposits. This cost reduction would in part offset the special assessment. Moreover, new entrants, if permitted, could lower FSLIC's costs and broaden the industry's capital base, thus potentially lessening the burden for existing healthy thrifts.

To date, the assistance of the twelve FHLBanks has remained relatively minor. The FHLBanks are owned by the industry, but linked to the FHLBB in myriad ways. They are well-capitalized institutions (1985 paid-in stock of $8.3 billion and surplus of $1.8 billion) with strong assets and earnings.

The FHLBanks issue consolidated debt, for which they are joint and several obligors, in the private capital markets. In part because of the FHLBanks' ties to the FHLBB, their paper trades as "agency" securities, with borrowing spreads close to Treasury securities.

The Garn-St Germain Act authorized the FHLBB to direct the FHLBanks to lend to FSLIC. There are possible variations on this loan approach, perhaps involving deposits, subordinated debt, and preferred stock. Authorizing legislation may be necessary for investments in FSLIC. Furthermore, any financing "package" must be attentive to the FHLBanks' position in the debt markets and to the operating needs of the thrift industry.

In addition, the FHLBanks could take some pressure off FSLIC by providing their standard advances to troubled thrifts without the FSLIC guarantee the FHLBanks require today. These advances might be a substitute for the "hot" money that finances certain weakened thrifts while FSLIC considers how to handle them. The advances would lower the risk and costs of a thrift on "hold" and ease the deposit bidding wars that hurt local healthy thrifts.

I met last week with the twelve presidents of the FHLBanks to discuss our ideas with them. They gave me some important insights. Most important, the FHLBank presidents are anxious to work with the Congress, the Bank Board, and the Treasury to fashion additional FHLBank support for FSLIC. We, in turn, will seek to arrange a FHLBank financing package that taps the Banks' skills and resources responsibly.

3. Expand the Acquisition Program for Ailing Thrifts

An increased acquisition effort offers one real option for expanding the set of institutions that can bear the cost of the thrift problem. Therefore, it is vital that we reexamine old beliefs about entry into the thrift business.

At a minimum, we must extend the emergency acquisition provisions of the Garn-St Germain Act, which expire April 15. In doing so, the Congress may wish to modify the statutory bidding process. The law now provides a second shot for some losing bidders through an awkward procedure that has prolonged the process and dampened other bidders' interest.

We also urge the Congress and the regulators to look twice before determining that certain classes of bidders, such as securities firms, cannot be accommodated in some fashion. Perhaps certain restrictions on affiliate transactions and conflicts of interest may suffice. In addition, some proposals before the Congress, such as the "tandem" restrictions, make thrift acquisitions exceedingly unattractive; they also strike a blow against consumers by prohibiting cross-marketing and other business connections that improve service and competition.

The regulators can also play an important role. The FHLBB has proposed a regulation that would increase the franchise value of a failing thrift: It would permit an acquiring S&L the right to expand into three additional states. The Bank Board is also taking steps to speed up the acquisition process and to market thrifts more actively.

The Federal Reserve Board has moved cautiously in permitting bank holding companies to acquire ailing thrifts. The FRB's tandem restrictions on BHCs' acquisitions of ailing thrifts are exceedingly stringent. The separation between an acquired thrift and other subsidiaries is much greater than that between the BHC's bank and those subsidiaries. These rules are vestiges of acquisitions during an earlier era when statutory interest rate differentials were in place, and before interstate banking compacts took hold. We surmise that the FRB is in part waiting for signals from Congress with respect to the current usefulness of such restrictions.

Summary on Thrifts

We wish to engage the Congress in this effort to help strengthen thrifts and resolve FSLIC's problems. We value highly your experience and insights. Equally important, we need your help to make real progress with the many players involved. We can make a start alone. But together we can develop a meaningful program that will make a difference.

III. Operational Deposit Insurance Issues

When Professors Milton Friedman and John Kenneth Galbraith are in agreement on an economics issue, I usually find it worthwhile to listen. So it is on deposit insurance. Both

gentlemen have stressed the key systemic protection afforded the nation's financial network by deposit insurance.*/ Moreover, it is important for America's small savers to have at least one totally safe investment.

I stated earlier that over time a deposit insurance system can be only as strong as the industry it stands behind. We are urging the Congress to permit the depository institutions to evolve with their marketplace -- for the sake of the customers they serve and the very health of those financial institutions. In addition, we also must recognize that periods of market adjustment, whether or not we wish it, will result in some institutions failing. It happens in all industries. While we need to avoid substantial costs to the public, the failure of less competitive firms is not an altogether unhealthy sign.

Failures of depositories, however, cause problems for the FDIC and FSLIC. They must manage the failure process so as to minimize disruption of the financial system and the lives of the depositors. I have just discussed such a "failure management" program in the context of FSLIC and the thrifts. Without presaging Chairman Seidman to a great degree, I would like to outline for this Committee some important operational "failure management" issues facing the FDIC. We share Chairman Seidman's interest in these matters and welcome an opportunity to work with this Committee to enhance the FDIC's ability to protect depositors and the financial system.

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*/ Professor Friedman wrote in 1963 in A Monetary History of the United States that:

> Federal insurance of bank deposits was the most important structural change in the banking system to result from the 1933 panic and, indeed in our view, the structural change most conducive to monetary stability since state bank note issues were taxed out of existence immediately after the Civil War.

Professor Galbraith explained in 1975 in Money: Whence it Came, Where it Went, that:

> The anarchy of uncontrolled banking [was] brought to an end not by the Federal Reserve System but by the obscure, unprestigious, unwanted Federal Deposit Insurance Corporation .... In American monetary history no legislative action brought such a change as this.

One frequently mentioned operational issue is the unequal treatment accorded large and small banks. The inequality arises in part because the FDIC does not have the tools to treat different size banks alike, while keeping costs and disruptions down. The FDIC needs the authority both to arrange purchase and assumption transactions with greater flexibility, and to ensure that stockholders, managers, and liability holders remain at risk.

For example, the FDIC has sought authority to acquire the voting or common stock of an insured bank in connection with an emergency assistance plan. A floor amendment to the Garn-St Germain Act prohibited such purchases. The FDIC has sought this power for two important reasons: to ensure that the shareholders bear their full loss and to give the FDIC time to operate the bank as a going concern while it examines the portfolio closely and readies the bank for sale. Such an "open bank rescue" helps preserve the bank's value and avoids a "fire sale." To avoid concerns about FDIC ownership of banks, the Congress could impose a reasonable time limit on the FDIC's ownership, perhaps with an extension if the FDIC makes certain certifications about the progress of audits, reorganizations, and marketing plans.

Two other key operational issues for any deposit insurer are the definition of deposit and the delineation of accounts eligible for insurance. Some court decisions have broadened the meaning of deposit to include, for example, letters of credit. We believe it is appropriate for the Congress -- in consultation with the FDIC and the FSLIC -- to define deposits by statute; we have concerns about a broad delegation of this powerful authority to the regulators.

The absence of priorities for creditor claims has at times tied the FDIC's hands (and increased its costs) when it has sought to arrange purchase and assumption transactions. We believe the Congress may wish to establish a depositor preference claim over other general creditors, as some states have done.

Another important "failure management" issue relates to the cost we are willing to force banking customers and the FDIC to bear to preserve historical geographic barriers to competition. Perhaps at one time these barriers had an important local value. But we need to reevaluate their cost today.

The Garn-St Germain Act only permits interstate rescue mergers of "failed" institutions of at least $500 million in assets. The same law permits interstate mergers of "failing" thrifts of any size. The FDIC should not be hamstrung in this fashion, especially if we wish it to: lower resolution costs; seek to maintain service to borrowers, depositors, and the community; and avoid disruptive bank liquidations.

An analogous problem arises in some unit banking states. The Congress should examine whether it is now time to permit the FDIC to allow failing banks to be operated as branches of their acquirers. Otherwise, some small, failing banks in rural communities are more likely to be closed and liquidated. In those exceptional circumstances, should the interests of the local bankers (or their regulators) triumph over those of other people in a small town?

Finally, the FDIC faces an important operational issue of how it will manage the poor quality assets of failed institutions. In the past, the FDIC often kept the poor quality assets after it arranged for another bank to assume the good assets and deposits. This approach has the unfortunate effect of making the FDIC the owner and liquidator of many loans. The FDIC has suggested that it may be time to leave more loans, even poor ones, within the private financial system. This approach has three benefits. It may make it easier for debtors to restructure their loans, it relies on private sector (often local) skills and incentives, and it eases the FDIC's organizational burden.

In summary, we believe there is much that can be done to improve the "failure management" capabilities of the deposit insurance agencies. But many reforms require Congressional action. Some issues will force us to reassess whether long-established barriers now hurt local borrowers and savers more than they protect them. The need is clear. The changes wrought by national, even international, financial markets cannot be disregarded. We have an opportunity to adapt our regulatory systems to them, so that consumers and small savers can be served better. I would like to assist this Committee in meeting the challenge.

IV. Conclusion

We will make our best effort to press forward now on these three consequential topics.

If banking organizations could engage in more services, they could attend much better than they can today to the needs of the public -- consumers, small businesses, state and local governments, America's corporations, and others. Just as important, especially from a safety and soundness point of view, is the exigent need for banking organizations to catch up with the evolution of the market; otherwise, they face economic obsolescence. Their regulation and supervision must adapt, too. It is to all our advantages to think creatively about safeguards for depositories owned by different types of firms, instead of trying to prohibit market and technological changes that we will never control or prevent. Moreover, the nation's consumers and small savers show no evidence of wanting to stop these beneficial changes.

The time also is ripe to make major advances on the problems of the thrifts and FSLIC. The necessity is plain and compelling. We must: (1) strengthen the industry and limit growth of the problem; (2) enhance FSLIC's capability, relying in part on the FHLBanks, to resolve more problem cases; and (3) reduce the burden on the industry by bringing in new capital and assisting FSLIC by promoting acquisitions of ailing thrifts.

We also will consider improvements in the deposit insurers' operational ability to manage failures. Some suggestions the FDIC is considering can enhance equitable treatment of banks, lower costs, and lessen disruptions to borrowers, depositors, and their communities.

Finally, and equally important, I wish to reaffirm the Treasury's commitment to work closely with this Committee and the Congress to address these challenges. We will refine our ideas with you. We will seek to answer your questions. If legislation is appropriate and opportune, we stand ready to assist in ways large and small.

I have appreciated this invitation to present our views today. And I respectfully look forward to many more exchanges in the future.

Mr. Chairman, I would be pleased to answer any questions the Committee may have.

FSLIC-Insured Institutions (September 30, 1985)

	All	Insolvent			Low Net Worth - 0-3% of Assets			Total - 3% Net Worth or Less		
		RAP 1/	GAAP 2/	TAP 3/	RAP	GAAP	TAP	RAP	GAAP	TAP
Number of firms	3,224	105	461	686	680	788	788	785	1,249	1,474
Assets ($billions)	1,042	22	114	343	253	320	346	275	434	689
Net Worth/Assets (%) (as measured, respectively, by RAP, GAAP, and TAP)		-4.9	-3.3	-4.7	1.93	1.84	1.63	1.38	.47	-1.5
Firms with positive net income in 3rd quarter	2,611	4	225	377	421	587	628	425	812	1,005
Net income ($millions)	1,052	-380	-379	-169	-60	91	462	-440	-288	293
Annualized ROA (%)	.41	-6.80	-1.32	-.20	-.10	.12	.54	-.64	-.27	.17

Source: FHLBB's Office of Policy and Economic Research

1/ Regulatory net worth.

2/ Net worth as defined under Generally Accepted Accounting Principles.

3/ Tangible net worth -- GAAP net worth less goodwill and other intangible assets.

TREASURY NEWS

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

LIBRARY, ROOM 5310

FOR RELEASE AT 4:00 P.M. March 4, 1986

MAR 6 3 48 PM '86
DEPT. OF THE TREASURY

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $13,600 million, to be issued March 13, 1986. This offering will result in a paydown for the Treasury of about $1,275 million, as the maturing bills are outstanding in the amount of $14,866 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, March 10, 1986. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,800 million, representing an additional amount of bills dated June 13, 1985, and to mature June 12, 1986 (CUSIP No. 912794 KK 9), currently outstanding in the amount of $16,161 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,800 million, to be dated March 13, 1986, and to mature September 11, 1986 (CUSIP No. 912794 LC 6).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing March 13, 1986. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,427 million as agents for foreign and international monetary authorities, and $3,586 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

B-489

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, 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 4, 1986

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DEPARTMENT OF THE TREASURY

Remarks by
Secretary of the Treasury
James A. Baker, III
at the Creve Coeur Club's
88th Annual Washington Day Dinner
The Civic Center
Peoria, Illinois
Tuesday, March 4, 1986

Good evening, and thank you, Bob, for that introduction. You know, ladies and gentlemen, George Washington -- the honoree of tonight's dinner -- once described friendship as "a plant of slow growth that must undergo and withstand the shocks of adversity." Well, folks, by that definition and after what Bob and I have been through these past several years in Washington, we're <u>really</u> good friends now.

So when Bob called me a couple of weeks ago and asked me to speak to you this evening, I was quick to accept -- partly because of that friendship and partly because Peoria has become pretty well-known in Washington lately. Bradley University's Braves and their best-in-the-country record have been front page news in a town where sports is almost as important as politics.

It's a pleasure to be here in Peoria tonight for this special occasion.

Americans really enjoy our myths and traditions. They entertain us. They inspire us. We use them to pass our values on to our children. Parson Weems' versions of the stories we associate with George Washington -- cutting down the cherry tree and tossing a silver dollar across the Potomac -- are cases in point.

But, as de Tocqueville said, Americans also "accept tradition only as a means of information and existing facts only as a lesson to be used in ...doing better." We like to examine and, as Bob will tell you is the case in Congress, argue at length the merits of various public policy options.

So what I'd like to do tonight is mention several myths that have had some currency in public policy discussions in recent months and share my point of view and experience with you on these topics.

The myths I have in mind are these:

- o Protection is the best way for American industry to respond to foreign competition.
- o The solution to the problem of a high deficit is to raise taxes.
- o The President's budget shortchanges those whose need is great and gives defense spending a bonus.

The myth may be that American industry is weak and needs protection, but the unassailable fact is that -- given a level playing field -- American industry can out-produce, out compete, and out-sell anybody, anywhere in the world.

While job creation in Western Europe remained flat, our economy gained nearly 10 million new jobs in just over three years and fueled the international recovery. Our toughest competitors, the Japanese, appreciate the value of our technology and the quality of our workforce. That's one of the reasons why Mitsubishi Motors joined Chrysler to build an auto assembly plant in Rockford. And that's happening all over the country, not just here in Illinois.

As the economic recovery has spread, we have seen a favorable convergence of international economic performance, largely as a result of working with the major industrialized countries to solve our problems.

Last September the finance ministers and central bankers of the G-5 nations -- Great Britain, France, West Germany, Japan and the United States -- gathered at the Plaza Hotel in New York.

Our goal was to adopt and implement policies that would lead to solid economic performance for all of us. We agreed that the exchange markets did not accurately reflect fundamental economic conditions and that some orderly appreciation of the non-dollar currencies against the dollar was desirable.

The dollar has come down more than 30 percent against the yen and the deutschemark in the past year. That's good news for all of you who are concerned about the trade deficit, and it is good news for industries and farmers in Illinois and elsewhere who face foreign competition. I have been receiving a number of encouraging comments just this evening from business leaders who are now more optimistic about our export picture.

Of course most exports and imports do not respond immediately to exchange rate changes. But we expect the trade deficit to shrink by the end of this year. Past experience suggests that by that time we will see the demand for imports weaken and stronger markets for our products overseas.

We now face the challenge of advancing our efforts to improve the international monetary system. The current system of floating rates remains valid. It has served us well during a series of global economic shocks, particularly because of its flexibility.

At the same time, the system has been less stable than we would have liked. As the President pointed out in his State of the Union address, we must be sensitive to the problems that "wild currency swings" cause our farmers and other exporters. Exchange rates are one factor -- though by no means the only one -- contributing to protectionist pressures.

President Reagan has asked me to determine if the nations of the world should meet to discuss the role and relationships of our currencies. Given the volatility of exchange rates over the last 15 years, we think it's worth considering whether some innovations might be made to encourage stability in the international monetary system.

I've been referring to our policies involving major industrial nations, but we must also remember that growth in the less developed world is extremely important to the United States. Jobs and income right here in Peoria depend on trade with those countries.

As you know, many of the less developed countries wrestle with problems stemming from their heavy loads of foreign debt. We believe that these LDCs can help themselves by adopting the kind of measures called for in the "Program for Sustained Growth" we announced at the annual meeting of the International Monetary Fund and World Bank last year in Seoul, Korea. So far, the response to the plan has been encouraging.

The other part of the equation is to push for free but also fair trade. In his address on trade last fall, President Reagan outlined how we must strengthen, extend, and modernize the trading system. He described the dangers of rushing blindly into protectionist "solutions" that risk disastrous trade wars.

Evidence is overwhelming that such conflicts are unwinnable. If our experience with the Smoot-Hawley tariff in 1930, that set off a trade war and significantly deepened the Great Depresssion, weren't enough to convince us, there is now a large and compelling body of economic scholarship to back up the point.

Protectionism, in reality, pits one American worker against another, one industry against another, one commmunity against another, and raises prices for everyone.

The best way to promote free and fair trade is through multilateral negotiations. We believe it's time for another GATT round as soon as possible. Such negotiations allow us to counterbalance powerful groups that <u>expect</u> to benefit from protectionism with those who <u>will</u> benefit from free trade.

Meanwhile, we are slowly but surely making progress in opening up markets in Japan and other countries on a bilateral basis. To combat subsidized imports or ones that are dumped on our markets we are continuing aggressive enforcement of the anti-dumping and countervailing duty acts.

Moreover, President Reagan is the first president in our country's history to initiate Section 301 cases to remove unfair trade barriers overseas. Until he assumed leadership in that area, industry had to go to the trouble and expense of making the first move.

The Special Trade Representative, Ambassador Yeutter has been negotiating removal of unfair trade practices in Korea, Taiwan, Brazil, and the European Community. We have resolved some issues and we will continue to press forward.

We cannot and will not continue to accept $150 billion trade deficits. The steps we are taking on international exchange rates and on enforcing the trade laws that we already have on the books <u>are</u> making a difference. We are beginning to turn the corner on the trade deficit problem and we're heading for better times. And that's no myth.

The second myth I mentioned a few minutes ago is that the solution to the high deficit is to raise taxes. And that's a fairly easy myth to refute. After all, the presidential candidate who ran on a platform of a tax increase carried only his own home state and the District of Columbia.

If American taxpayers have to dig deeper into their pockets to pay the country's bills, the wrong people are being asked to tighten their belts. The President is absolutely in tune with the American people on this issue. We do not face large deficits because the American people are undertaxed. We face them because the federal government overspends.

Experience has already proved that higher taxes reduce incentives for Americans to work, save, and invest -- choking off the tremendous job-creating capacity of the economy. Nor is it clear that higher taxes would reduce the deficit. Experience has shown that such revenues are used for more federal spending, not for deficit reduction.

And while I'm on this point let me shoot down a related myth, that the Reagan tax cuts of 1981 caused the deficit. Tax revenues which had soared to over 20 percent of GNP before those cuts fell to 19 percent -- the same average range that prevailed from 1952 to 1979. But spending rose to 24 percent of GNP last year, a substantial increase above the 20 percent average during the 1960s and '70s.

Over the past five years we've made some real strides toward reducing the burden of government on the economy. We've started down the road to responsible deficit reduction, paving the way for sound fiscal and monetary policy at home. And we have underway a historic effort at achieving significant tax reform that will allow Americans to channel their economic energy into productive enterprise, rather than tax shelters.

True tax reform will lead our country into increased productivity and growth. And true tax reform also means a tax system that is fair -- ensuring that everybody pays his fair share -- but no more. It will take bipartisan support to achieve a tax reform bill that meets the standards the President has set.

This week the first cuts mandated by the legislation that commits the federal government to a balanced budget by year 1991 took effect. And contrary to widespread misunderstanding, the Gramm-Rudman-Hollings legislation's automatic spending cuts are triggered only if Congress fails to pass a budget that meets its deficit target limits.

While one provision of the law has been challenged and will be reviewed by the Supreme Court, it is the law of the land and it is a big step in the right direction.

The President has submitted a budget to Congress for Fiscal Year 1987 that meets the deficit target of $144 billion. The Congress must now make some tough choices. Cutting the deficit involves difficult decisions. We must fund essential programs and we must maintain the social safety net and we must provide for modest but steady growth in defense.

Mentioning the social safety net leads me to the last myth I want to talk about -- the peculiar idea that President Reagan's budget distorts the nation's values and priorities.

Leave aside the fact that the President grew up here in Illinois and knew the dark days of the Depression from the underside. Leave aside the fact that the President came to conservative economic views after many years as an FDR liberal.

Look to the fact that contrary to the common impression, the brunt of the President's proposed cuts does not fall on the poor. The President is not asking for many changes in programs -- aid to families with dependent children, supplemental security income, food stamps and the like -- which serve the truly needy and comprise the social "safety net." Overall, real outlays for safety net programs rose 12 percent from 1980 to 1985 and will continue to rise through the President's second term.

Compared to spending for human resources and other nondefense programs, military spending is not a great burden on our economy. Defense expenditures today, as a fraction of the Gross National Product, are smaller than in any year between 1951 and 1972.

With the Administration's present plans, defense spending would stand at 6.2 percent of GNP by 1991. This percentage would still be less than that in any year of the Eisenhower, Kennedy or Johnson Administrations.

And the President will not tolerate waste in the Pentagon any more than he would accept it in other government programs. Last week he welcomed a report from the Packard Commission which outlined improvements and potential savings in our military procurement system.

This administration is guided by two principles. One: we aim to achieve the essential task of reducing the deficit without harming our defense and social needs. We are going to create a leaner, better-integrated, more streamlined Federal government -- stripped of marginal, nonessential and inappropriate functions and activities. The other is to enable each American to overcome dependency -- to achieve independence and self-confidence.

The President has commissioned an evaluation of the programs and strategies the federal government supports to meet the financial, educational, social, and safety concerns of poor families. He has also asked the Secretary of Health and Human Services to report on how the private sector and government can work together to address the problems caused by catastrophic illness.

Helping those who need assistance is one of the most important threads in the fabric of American life. Ours has always been a nation of givers -- volunteers, open-handed charity, and neighborly cooperation.

It has been estimated that more than half of all American adults -- 92 million people -- work in their spare time for some worthwhile cause or contribute to it with their hard-earned dollars.

And that attitude is alive here in Peoria and all over America. It's the kind of spirit that -- in President Reagan's words -- "makes me absolutely convinced that this country's future is ours to shape -- that no problem is beyond our ability to solve."

I'm not by nature a cheerleader, but I am absolutely convinced, after my experiences in Washington, that this country really is poised for greatness. I've now served in two Cabinet departments and for four years at the White House.

I've seen firsthand how in only five short years we have turned national frustration into national rededication. I've seen 39 straight months of economic growth, interest rates cut in half, and inflation falling from over 12 percent in 1980 to under 4 percent for the past four years in a row.

But there has been something else growing in this country as well -- a resurgence of pride and hope, even in the face of some problems that we must face and solve together. And despite some of the concerns that you have here in Illinois and here in Peoria, there is much to be proud of.

I'm reminded of some words written by a midwesterner, Wendell Willkie, who rose from his boyhood in Indiana to run for President. "I believe in America because in it we are free -- free to choose our government; to speak our minds; to observe our different religions.

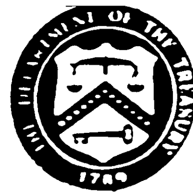
"Because we are generous with our freedom and share our rights with those who disagree with us. Because we hate no people and covet no people's land. Because we are blessed with a natural and varied abundance.

"Because we have great dreams and because we have the opportunity to make those dreams come true."

From the earliest days of our country's history, we have been a people known for our rockhard, clear-eyed realism. We are also a nation that has drawn strength from our traditions. And we have inspired the whole world with our dreams.

The world's hopes <u>do</u> rest with America's future and America's hopes <u>do</u> rest with us. As your native son and statesman Adlai Stevenson said, we must resolve "to serve our great traditions, greatly."

Thank you and God Bless You.

TREASURY NEWS

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FOR RELEASE UPON DELIVERY
March 6, 1986

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MAR 9 ... '86

TREASURY

STATEMENT OF THE
HONORABLE CHARLES O. SETHNESS
ASSISTANT SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
THURSDAY, MARCH 6, 1986

Mr. Chairman, and Members of this Distinguished Committee:

I am pleased to have this opportunity to present the Administration's views on the difficulties facing insured agricultural banks. I look forward to working closely with you on this and other financial institutions issues.

The problems in our agricultural sector have created serious financial and personal difficulties for many farmers. These problems have made it hard for some farmers (especially the most highly-leveraged producers) to repay their loans. As a result, there has been a substantial increase in the number of nonperforming assets at agricultural banks and other farm lending institutions (e.g., the Farm Credit System).

We are alert to these problems. Nevertheless, we also must examine this issue in a fair perspective, given the many demands on the Federal Government's resources today. For example, according to the Federal Reserve, 80 to 85 percent of all farmers remain in sound financial condition.

Agriculture is going through a major transition in America. And it must do so if it expects to compete effectively for export markets. The new Farm Bill will spend at least $50 billion over the next few years to ease the way. The lower dollar will help, too.

Current USDA economic projections anticipate several more years of severe pressure on farmers, rural communities and agricultural lending institutions. But USDA expects the capacity-demand mismatch to improve and land values appear to be bottoming out in many parts of the country.

Despite the difficult near-term outlook, the Administration believes the bank regulatory structure and the farm assistance programs currently in place make the problems at agricultural banks manageable. We believe, however, that it is critical for the bank regulatory agencies to continue to work constructively with farm banks on their problems and the concerns of their borrowers. We will strive to assist the regulators in this task.

The remainder of my statement: (1) presents an overview of the nature of the financial problems of agricultural banks; (2) discusses how recent legislation strengthening the Farm Credit System (FCS) and the programs of the Farmers Home Administration (FmHA) benefit these banks; and (3) addresses the major special assistance programs that some agricultural bankers are requesting.

Financial Problems of Agricultural Banks

Most agricultural banks* are still sound. But the number of individual banks with problem loans is increasing. The agricultural banking sector will continue to face trying times until agricultural incomes and land prices stabilize. The FDIC and OCC have stated, however, that they do not believe agricultural bank problems will affect the safety and soundness of the banking system.

The banking sector's direct exposure to the agricultural sector is limited to slightly over two percent of total commercial bank assets. Only about 23 percent of total farm debt, (i.e., $48 billion in direct loans) is held by commercial banks.** About half of that commercial bank credit ($24 billion) is held by banks that are diversified and thus better able to absorb nonperforming agricultural loan losses. The other $24 billion of commercial bank agricultural loans is held by almost 4,000 agricultural banks.

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* Agricultural banks are defined here as those with over 25 percent of their gross loans in agricultural credits (loans secured by farm land, loans to finance agricultural production and other loans to farmers).

** The Federal Reserve Board estimates that at year-end 1985 total U.S. farm debt equaled about $210 billion. Commercial banks held about 23 percent of the total farm debt, the Farm Credit System (FCS) held about 29 percent, the Farmers Home Administration (FmHA) held about 13 percent, life insurance companies and the Commodity Credit Corporation held about 13.5 percent, and individuals and others held the remaining 21.5 percent.

Historically, agricultural banks have enjoyed higher earnings, higher capital levels, and lower loan losses than nonagricultural banks. Therefore, in spite of their present problems, agricultural bank capital is still reasonably strong. On September 30, 1985, 50 percent of the agricultural banks had reported capital-to-asset ratios of over 10 percent, 37 percent had reported capital between 8 and 10 percent, 12 percent had reported capital between 6 and 8 percent and only 1 percent had reported capital below 6 percent. As a group, their capital-to-asset ratio of 9.75 percent was well above the average of 7.5 percent for the entire banking system.

Obviously, there is a great disparity in the condition of individual agricultural banks. There may also be a number whose apparently high capital does not reflect fully the continued deterioration in their loan portfolios. In addition, the troubled banks are concentrated geographically. Sixty-two agricultural banks failed in 1985 -- just over one percent of all farm banks. But 52 were located in the Midwest and Great Plains states, where the farm economy has been hit most severely by the weak export market for American farm products. The failed banks are generally extremely small; the average asset size of failed agricultural banks in 1985 was just under $20 million.

We also must be careful not to suggest that all bank failures deprive small communities of their local lenders. Late last year, the FDIC testified in the House that 40 of the 50 agricultural banks that had failed as of that time had been reopened -- either as free-standing banks or as branches of another bank. This fact does not deny the hardship to the banker and some problem borrowers. But clearly we have ways to maintain credit in rural towns and communities without resorting to possibly costly solutions to assist all troubled banks.

The FDIC expects that in 1986 farm bank problems will continue at levels at least equal to those experienced during the recent past. It estimates that losses on total farm loans for all lenders will range from about $7 billion to $20 billion over the next three to four years. Farm loan charge-offs at commercial banks are estimated to have reached $1.5 billion in 1985. When combined with farm loan losses at other lenders, the total for 1985 would exceed $3.0 billion.

Most agricultural banks are handling their problems well and remain sound institutions. Farmers, their bankers, and the bank regulators are working together to solve loan repayment problems. Nevertheless, if the farm economy does not improve over the next few years, many marginal farmers and their banks will continue to face hard times.

Farm Credit Amendments Act of 1985

Late last year, I was deeply involved with the drafting and enactment of the Farm Credit Amendments Act of 1985, which the President signed into law on December 23, 1985. Because this legislation moved so rapidly, many people remain only partially informed about its contents and effects. I would like to describe the Act briefly for you, because agricultural banks will benefit notably from its passage.

The Act strengthens the Farm Credit System (FCS) in three major ways. First, it enables the FCS to help itself by transferring its substantial surplus to those districts in greatest need of capital. This additional capital will help hard-pressed FCS districts to absorb losses and work with debt-stressed farmers. Second, the Act reforms the Farm Credit Administration by making it an arms-length regulator and granting it powers to ensure that FCS lenders operate in a safe and sound manner. Third, the new law gives a carefully restricted "backstop" to the FCS to ensure its ability to fund itself in the capital markets.

Some agricultural bankers have contended that since Congress enabled the Farm Credit System to help itself, Congress should help them. This reasoning is highly ironic. It ignores: (1) the significant differences between the FCS and farm banks, as well as the nature of the help FCS received; and (2) the critical fact that a viable FCS helps agricultural banks in many ways.

First, the FCS differs from banks. It is a privately owned cooperative that is chartered by Congress to supply credit and closely related services to farmers and ranchers. The System's approximately 800 constituent units are linked by: (1) their reliance on consolidated borrowings in public debt markets (about $68 billion outstanding); (2) the joint and several liability of the 37 System banks that play the key intermediary role; (3) loss-sharing contracts; and (4) their common legal establishment under the Farm Credit Act of 1971.

The FCS is chartered by Congress to serve only one sector of our economy: agriculture. It does not have the diversified asset powers that banks enjoy. In addition, the FCS raises money in the bond markets, whereas banks fund themselves through deposits -- with liquidity assured by deposit insurance and the Fed's discount window. If bond market investors lose confidence in FCS, there is no FDIC to stop the run.

One major assistance given the FCS by the 1985 Act was the authority to shift surplus capital from healthy institutions to the weaker ones -- something that the commercial

banks are not likely to propose for themselves. Moreover, the package included a new requirement that FCS lenders must prepare independently audited financial statements according to generally accepted accounting principles (GAAP) -- just when the banks are seeking to loosen their accounting standards.

Second, a viable FCS helps agricultural banks in at least four ways:

(1) Commercial banks are the largest single holder of FCS bonds; if these bonds were to lose value, many agricultural banks would suffer sizable losses.

(2) FCS fills an important lending niche that most agricultural banks avoid: making long-term land loans. If FCS funds were not available, the banks would be pressured to meet this need of farmers. Federal Land Banks currently hold about $49 billion of farm debt (23 percent of the total outstanding), accounting for about 60 percent of farm mortgage finance.

(3) If FCS could not roll over its debt, it would have to liquidate its farm loans -- depressing the value of farm land and other farm assets even further. Such a decline in farm collateral values would severely damage agricultural banks.

(4) Finally, FCS's owners are its farmer-borrowers. If they lose the value of their stock because FCS cannot pay its debts, many farmers will be unable to repay their loans from agricultural banks.

This winter the FCS forecasted that its total losses will be in the range of $5-$6 billion over years 1985 through 1987. As of September 30, 1985, FCS had $5.5 billion in earned surplus, $5.3 billion in borrower stock, and $1.6 billion in loss reserves.

FCS reported a $2.7 billion loss for 1985, leaving $3.4 billion of earned surplus and loan loss reserves of $3.2 billion. The System's large loss has not disturbed the market for the bonds it sells to raise funds. Since Congress passed the Farm Credit Amendments Act, the yields on the bonds have narrowed to between 30 and 55 basis point above comparable Treasury bill yields, and even narrower spreads over the yields for other "agency" borrowers. These borrowing rates are comparable to those for healthy major corporate borrowers.

Benefits of the Farmers Home Administration Programs

The Farmers Home Administration (FmHA) -- an agency within the U.S. Department of Agriculture that holds 13 percent of total farm debt -- also relieves the pressure on agricultural

banks in several ways. FmHA is a lender of last resort for farmers, other rural residents, and communities unable to obtain credit at affordable rates and terms from commercial lenders. At the end of September 1985, the agency had about 270,000 farm and ranch borrowers.

The FmHA's major farm loan programs include:

(1) Farm operating loans. These are usually one-year loans to help farmers cover the cost of producing a crop. In fiscal 1985, FmHA obligated $4.7 billion for operating loans, about $1.1 billion of which was for guaranteed loans.

(2) Farm ownership loans. These are long-term loans to assist in acquiring farms. The FmHA made $720 million in ownership loans in fiscal 1985.

(3) Disaster emergency loans. These are designed to help farmers recover from the effects of a natural disaster such as drought or flood. The budget for emergency loans varies according to the number of officially declared disasters; in fiscal 1985 and 1984, FmHA made $491 million and more than $1 billion in emergency loans, respectively.

During fiscal 1985, the Secretary of Agriculture, employing his discretionary authority, provided special credit assistance to over 152,000 FmHA farm borrowers, more than double the number of borrowers in 1984. Special credit assistance included deferral of loan payments, rescheduling, and subordination of liens to commercial lenders in the private sector.

In addition, in September 1984, the Administration introduced a FmHA debt reduction program to help farmers and banks. Under this program, the FmHA guarantees up to 90 percent of renegotiated loans on which a bank has written down the principal and/or reduced the interest charge sufficiently for the borrower to service his debt. There has been surprisingly little use of this program by the banks.

The newest FmHA program to assist farmers and their bankers was authorized by the 1985 Farm Bill. The Act directs the Secretary of Agriculture to establish an interest rate reduction program for loans made by commercial banks and guaranteed by the FmHA. Under the program, a commercial lender must reduce the interest rate on a farm loan by a specified minimum amount to allow a farmer to have a positive cash flow. Then the Secretary can make a payment to the lender in an amount equal to up to 50 percent of the cost of the interest rate reduction. This payment may not exceed the cost to the government of reducing the rate by more than two percent. The term of the interest rate reduction contract may not exceed the remaining loan term, or three years, whichever is shorter.

The amount of funds available for this program can total up to $490 million; the program runs until September 30, 1988. Clearly, banks with problem loans and their farmer-borrowers have much to gain from this sizable expenditure program.

Proposed Special Assistance Programs for Agricultural Banks

There are several special assistance measures proposed by the agricultural banking community and others. These include: (1) issuing net worth certificates; (2) permitting extended loan write-down periods; (3) creating additional programs for principal or interest rate buydowns; (4) placing a moratorium on foreclosures; and (5) relaxing state laws to ease the preservation of banking services to communities with a failing bank. I will review each of these proposals briefly.

Net Worth Certificates (NWC). NWCs were first authorized by the Garn-St Germain Act of 1982. The Act permits the FDIC and FSLIC to purchase NWCs from qualified insured thrift institutions in exchange for promissory notes, in order to assist institutions experiencing losses due mainly to interest rate spread problems. Since NWCs qualify as capital for regulatory purposes, they in theory allow thrifts time to restore capital to adequate levels.

Some members of the banking industry have asked Congress to expand the program to provide paper capital to agricultural banks -- this time to offset losses on problem loans, not losses due to negative interest margins.

The major disadvantage of this program is that the ultimate costs could be very high. If the farm economy did not turn around soon, the FDIC would have to pay off many of the holders of the promissory notes at substantial cost. Moreover, the managers of institutions kept alive in this fashion have an incentive to take greater risks: If their gamble pays off, they stay in business; if they lose, the FDIC would pick up the tab.

The program would also disguise the true state of capital adequacy and violate generally accepted accounting principles. As we have seen in the case of the thrifts, "creative" bookkeeping can undermine confidence in a whole industry. In addition, while in theory this program could be directed only at fundamentally sound banks in temporary trouble, in practice it is difficult to set this criterion and to stick to it.

Permitting Extended Loan Write-Down Periods. A second type of proposal would supercede accounting rules by permitting banks to extend loan write-downs over a number of years. Currently, a bank must book a loan loss when it determines that a portion of the loan is no longer likely to be paid back.

Allowing a bank to amortize loan losses over an extended period is really the same as allowing it to overstate its capital position. This approach may undermine the public's knowledge of, and confidence in, a bank's financial condition. It also runs the risk of increasing the FDIC's costs by keeping fundamentally insolvent institutions alive with no real capital at risk.

The advantage of the loss deferral proposal over NWCs is that NWCs involve a promissory note by the FDIC. If the bank fails, the FDIC must pay off the note. The loss deferral program simply overstates the capital buffer between the losses and the FDIC.

The Comptroller's Office is examining the risks and benefits of a variant of loan loss amortization. In effect, it may be able to "regularize" a capital rebuilding schedule for banks whose capital has fallen below supervisory standards, but which have reasonably good prospects for recovery over time. If workable, this approach may help limit credit contraction; otherwise, percentage lending limits may force a bank with a reduced capital base to reduce loans outstanding.

Principal or Interest Rate Buydowns. The Administration's newly authorized $490 million program for the FmHA offers an example of how an interest rate buydown can work. The Federal Government and the lender share the cost of reducing the principal or debt service on a loan -- to an amount the borrower can manage. This type of program increases the likelihood that a satisfactory work-out can be arranged between the farmer and the lender.

This type of program may encounter problems, however, if a farmer has several lenders. If one lender decides to reduce his loan's interest rate so as to return the borrower to a positive cash flow, the other lenders will have improved their positions at the first lender's expense. Requiring coordination between the lenders would help distribute losses more equitably, but could involve administrative problems.

The Administration wants to make the existing buydown program work. FmHA published regulations for it in the Federal Register on February 25, 1985; and farmers and bankers can take advantage of it immediately.

Given the cost of this approach, it would be imprudent to expand outlays before we even have seen how the first sum works. Neither Congress nor the Administration can accept a budget busting addition now.

A Moratorium on Foreclosures. Some have suggested placing a moratorium on foreclosure proceedings against farmers who fail to keep up their debt service payments. This approach ends up hurting both farmers and lenders.

First, a moratorium would have a chilling effect on future farm lending, especially for young or marginal borrowers.

Second, a moratorium would not improve a farmer's cash flow or help him or her to obtain additional credit for continuing operations. It just buys some time, perhaps at the cost of some further erosion of the farmer's capital. If farmers are facing foreclosure, they are experiencing more than temporary difficulties. For the last few years, bank regulators have encouraged forbearance on farm loans so that banks will resort to foreclosure only when no mutually satisfactory plan to make the loans payable can be worked out.

Third, a moratorium would overwhelm many farm banks. Farmers would have less incentive to keep their loans current. The banks could not liquidate any of their nonperforming loans; they would be locked into continuing losses from the interest carrying costs.

Relaxing State Laws to Maintain Rural Credit. Some restrictive state laws -- pertaining to farm ownership, unit banking, and out-of-state acquisitions -- exacerbate current problems. Restraints on farm ownership reduce the demand for, and hence the price of, farm land. Unit banking states limit the ability of banks to weather losses through offsetting profits from a more diversified lending base. Moreover, states that still require acquirers of failing banks to run the banks as stand-alone operations make it hard or impossible for the FDIC to arrange purchases that could maintain banking service for many communities. Neither our rural citizens nor the FDIC can continue to afford barriers to branching in emergency situations.

Similarly, the emergency acquisition provisions of the Garn-St Germain Act of 1982 severely restrict acquisitions of troubled banks across state lines: The bank must have failed, and must have assets of at least $500 million. This is "populism" for a few bankers -- but not for farmers, not for people in small towns, and not for the other bankers who must finance the FDIC. The emergency acquisition provisions will expire on April 15 unless the Congress extends them. If we want to manage the failure of small banks better -- so borrowers and small savers are helped -- Congress should eliminate these restrictions and extend the emergency provisions.

Conclusion

Agricultural bankers deserve our respect for their able handling of the challenges caused by the massive structural changes now taking place in the agricultural sector. But we must be careful about taking "crisis" actions that will cost us dearly over time without really helping most farmers or bankers.

We will seek full utilization of existing programs that give temporary aid to basically sound farmers and farm bankers who are encountering short-term problems. These supports are not insignificant. The Farm Credit System has just chartered its new Capital Corporation in order to channel System reserves where needed most. The Farmers Home Administration has already begun to put in place its new $490 million interest rate buydown program, and its other lending programs can continue to help both farmers and bankers.

We also will continue to work with the bank regulators to consider the best means possible to ease the plight of farmers and bankers during this exceedingly difficult transition period. We must recognize, however, that regulators also have a long-term duty to ensure that banks are soundly run and capitalized, so as to protect borrowers, lenders, and the deposit insurance funds.

The new special assistance programs that have been proposed are, for the most part, problematical in many respects. There is no panacea. In varying degrees, the proposals: (1) run the risk of actually weakening the banking industry over time; (2) will likely be very expensive, either now or in the future; and (3) pose serious questions of equity as between lenders to various sectors of the economy.

We recognize the seriousness of the agricultural bank problem to important areas of the nation. We will keep at it. We will consider carefully all proposals to assist agricultural banks and will continue to work with the Office of the Comptroller, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Department of Agriculture to develop approaches essential to the long-term well-being of the agriculture credit sector.

Mr. Chairman, that concludes my prepared statement. I would be happy to answer any questions the Committee may have.

federal financing bank NEWS
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DEPARTMENT OF THE TREASURY

FOR IMMEDIATE RELEASE March 7, 1986

FEDERAL FINANCING BANK ACTIVITY

Francis X. Cavanaugh, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of January 1986.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $153.7 billion on January 31, 1986, posting an increase of $0.3 billion from the level on December 31, 1985. This net change was the result of increases in holdings of agency debt and agency assets of $0.1 billion each and in holdings of agency-guaranteed debt of under $0.2 billion. FFB made 286 disbursements during January.

Attached to this release are tables presenting FFB January loan activity, commitments entered during January, and FFB holdings as of January 31, 1986.

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B-492

FEDERAL FINANCING BANK

JANUARY 1986 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
TENNESSEE VALLEY AUTHORITY					
Advance #556	1/2	$ 223,000,000.00	1/8/86	7.405%	
Advance #557	1/6	356,000,000.00	1/13/86	7.415%	
Advance #558	1/8	30,000,000.00	1/15/86	7.385%	
Advance #559	1/8	317,000,000.00	1/16/86	7.385%	
Advance #560	1/13	342,000,000.00	1/20/86	7.565%	
Advance #561	1/16	37,000,000.00	1/21/86	7.545%	
Advance #562	1/16	134,000,000.00	1/22/86	7.545%	
Advance #563	1/20	6,000,000.00	1/24/86	7.455%	
Advance #564	1/20	362,000,000.00	1/27/86	7.455%	
Advance #565	1/22	106,000,000.00	1/31/86	7.365%	
Advance #566	1/27	35,000,000.00	2/1/86	7.315%	
Advance #567	1/27	324,000,000.00	2/3/86	7.315%	
Advance #568	1/31	281,000,000.00	2/6/86	7.395%	
Power Bond Series 1986 A	1/16	150,000,000.00	2/29/16	9.685%	
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
Note #377	1/3	950,000.00	4/1/86	7.455%	
Note #378	1/7	3,000,000.00	4/7/86	7.415%	
Note #379	1/8	1,500,000.00	4/8/86	7.385%	
+Note #380	1/13	42,630,000.00	4/14/86	7.575%	
+Note #381	1/17	550,000.00	4/17/86	7.435%	
+Note #382	1/27	14,450,000.00	4/29/86	7.335%	
+Note #383	1/27	5,000,000.00	4/29/86	7.335%	
AGENCY ASSETS					
FARMERS HOME ADMINISTRATION					
Certificates of Beneficial Ownership					
	1/1	80,000,000.00	1/1/01	9.395%	9.616% ann.
	1/31	40,000,000.00	1/1/01	9.455%	9.678% ann.
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Egypt 7	1/2	3,023,002.40	7/31/14	9.595%	
Turkey 18	1/2	942,079.93	3/12/14	9.115%	
Greece 15	1/6	177,040.00	6/15/12	9.395%	
Morocco 11	1/6	28,367.07	9/8/95	8.355%	
Egypt 6	1/7	523,827.82	4/15/14	9.485%	
Egypt 7	1/7	940,921.00	7/31/14	9.635%	
Greece 14	1/7	533,840.70	4/30/11	9.608%	
Indonesia 10	1/7	20,402.00	3/20/93	8.695%	
Morocco 11	1/7	191,996.29	9/8/95	8.365%	
Peru 9	1/7	24,389.00	9/15/95	9.119%	
Egypt 7	1/9	1,610,134.99	7/31/14	9.605%	
Jordan 12	1/9	1,039,764.00	2/5/95	9.095%	
Botswana 4	1/10	36,525.40	7/25/92	8.405%	
Niger 2	1/10	100,000.00	10/15/90	8.401%	
Niger 3	1/10	100,000.00	5/15/95	7.816%	
Philippines 10	1/10	920,924.00	7/15/92	9.065%	

+rollover

FEDERAL FINANCING BANK

JANUARY 1986 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual	INTEREST RATE (other than semi-annual)
Foreign Military Sales (Cont'd)					
Portugal 1	1/10	$ 19,120,924.00	9/10/94	9.223%	
Portugal 2	1/10	14,279,076.00	9/10/95	8.723%	
Thailand 12	1/10	3,383,983.00	3/20/96	9.219%	
Turkey 18	1/13	1,110,112.20	3/12/14	9.495%	
Egypt 7	1/13	7,169,191.60	7/31/14	9.833%	
Turkey 18	1/14	5,469,354.00	3/12/14	9.605%	
Spain 8	1/14	4,232,680.00	3/25/96	8.935%	
Jordan 12	1/14	238,742.00	2/5/95	9.465%	
Egypt 7	1/14	10,442,119.00	7/31/14	9.945%	
Colombia 7	1/14	1,442,879.00	9/5/91	8.415%	
Spain 8	1/15	8,962.08	3/25/96	8.875%	
Peru 10	1/15	75,054.00	4/10/96	9.495%	
Tunisia 17	1/15	27,750.00	9/15/96	9.245%	
Philippines 10	1/16	323,347.38	7/15/92	9.095%	
Egypt 6	1/16	1,516,969.83	4/15/14	9.595%	
Egypt 7	1/16	50,000,000.00	7/31/14	9.702%	
Morocco 11	1/16	232,017.14	9/8/95	8.585%	
Morocco 12	1/16	37,154.56	9/21/95	9.365%	
Egypt 7	1/17	7,916,286.87	7/31/14	9.685%	
Turkey 18	1/21	3,582,062.25	3/12/14	9.360%	
Jordan 12	1/21	1,224,100.78	2/5/95	9.205%	
Greece 15	1/21	6,901,034.76	6/15/12	9.538%	
Egypt 6	1/21	363,842.03	4/15/14	9.575%	
Dominican Republic 8	1/21	67,006.83	4/30/96	8.786%	
Thailand 12	1/22	6,919,205.00	3/20/96	9.218%	
Niger 2	1/22	111,325.49	10/15/90	8.437%	
Morocco 13	1/22	150,437.70	5/31/96	9.005%	
Botswana 4	1/22	180,994.74	7/25/92	8.325%	
Jordan 12	1/22	2,444,497.00	2/5/95	9.212%	
Turkey 18	1/22	28,442,225.10	3/12/14	9.374%	
Egypt 7	1/22	500,980.14	7/31/14	9.635%	
Indonesia 10	1/28	492,490.00	3/20/93	8.775%	
Jordan 12	1/28	15,212,861.00	2/5/95	9.159%	
Greece 15	1/28	1,511,407.40	6/15/12	9.435%	
Egypt 6	1/28	840,541.00	4/15/14	9.535%	
Colombia 7	1/28	989,542.65	9/5/91	8.235%	
Jordan 12	1/30	685,990.00	2/5/95	9.145%	
Tunisia 16	1/30	198,857.32	2/4/96	9.215%	
Tunisia 17	1/30	553,158.68	9/15/96	8.932%	
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
Biloxi, MI	1/6	450,000.00	5/1/87	7.905%	8.061% ann.
Harrisburg, PA	1/6	200,000.00	2/1/87	8.125%	8.290% ann.
Massillon, OH	1/6	280,000.00	9/15/86	7.685%	7.767% ann.
Newport News, VA	1/13	136,500.00	2/18/86	7.565%	
Albany, NY	1/14	212,600.00	7/1/03	9.702%	9.937% ann.
Albany, NY	1/14	500,000.00	7/1/03	9.702%	9.937% ann.
Springfield, MA	1/14	574,351.05	8/1/86	7.855%	7.885% ann.
Biloxi, MI	1/23	50,000.00	5/1/87	8.005%	8.165% ann.
St. Louis, MO	1/27	1,250,000.00	2/18/86	7.315%	
Ponce, PR	1/27	2,297,923.00	8/1/86	7.595%	7.606% ann.
Atlanta, GA	1/27	1,860,000.00	2/1/86	7.315%	
Omaha, NE	1/29	285,000.00	12/1/86	7.655%	7.773% ann.
Lorain, OH	1/29	150,000.00	9/2/86	7.555%	7.599% ann.
Indianapolis, IN	1/31	123,500.00	2/3/86	7.395%	

*maturity extension

FEDERAL FINANCING BANK

JANUARY 1986 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF THE NAVY					
Ship Lease Financing					
+[illegible]	1/15	$ 43,316,650.34	4/15/86	7.605%	
+Darnell	1/15	44,561,684.08	4/15/86	7.605%	
+Buck	1/15	47,642,729.54	4/15/86	7.605%	
+Lopez	1/15	113,852,682.12	4/15/86	7.605%	
+Williams	1/15	116,422,407.03	4/15/86	7.605%	
+Bobo	1/15	118,839,782.17	4/15/86	7.605%	
+Obregon	1/15	107,879,688.62	4/15/86	7.605%	
+Kocak	1/15	104,788,142.81	4/15/86	7.605%	
+Bonnyman	1/15	124,086,023.84	4/15/86	7.605%	
+Fisher	1/15	117,268,592.12	4/15/86	7.605%	
+Anderson	1/15	120,680,368.76	4/15/86	7.605%	
+Pless	1/15	105,919,489.26	4/15/86	7.605%	
+Baugh	1/15	122,312,472.03	4/15/86	7.605%	
+Hauge	1/15	126,322,576.50	4/15/86	7.605%	
+Lopez Container	1/15	2,200,359.00	4/15/86	7.605%	
+Williams Container	1/15	2,200,359.00	4/15/86	7.605%	
+Bobo Container	1/15	2,200,359.00	4/15/86	7.605%	
+Bonnyman Container	1/15	1,584,382.08	4/15/86	7.605%	
+Fisher Container	1/15	1,584,418.71	4/15/86	7.605%	
+Pless Container	1/15	2,330,000.00	4/15/86	7.605%	
Defense Production Act					
Gila River Indian Community	1/21	338,610.84	10/1/92	8.817%	8.722% qtr.
Gila River Indian Community	1/27	184,023.42	10/1/92	8.797%	8.702% qtr.
RURAL ELECTRIFICATION ADMINISTRATION					
Allegheny Electric #304	1/3	487,000.00	12/31/18	9.456%	9.347% qtr.
*Wabash Valley Power #104	1/3	6,327,000.00	1/3/88	8.145%	8.064% qtr.
*Wabash Valley Power #206	1/3	12,306,000.00	1/3/88	8.145%	8.064% qtr.
*Wolverine Power #101	1/3	1,936,000.00	3/31/88	8.208%	8.125% qtr.
*Wolverine Power #182	1/3	4,869,000.00	12/30/88	8.385%	8.299% qtr.
*Wolverine Power #183	1/3	5,452,000.00	12/30/88	8.385%	8.299% qtr.
*Corn Belt Power #55	1/3	232,000.00	12/31/13	9.484%	9.374% qtr.
*Corn Belt Power #94	1/3	448,000.00	12/31/13	9.484%	9.374% qtr.
*Kansas Electric #216	1/3	10,900,000.00	12/31/15	9.476%	9.366% qtr.
*Saluda River Electric #186	1/3	8,640,000.00	12/31/15	9.476%	9.366% qtr.
*Continental Tel. of Texas #119	1/3	1,819,000.00	12/31/15	9.476%	9.366% qtr.
*Brazos Electric #108	1/3	409,000.00	12/31/18	9.461%	9.352% qtr.
*Brazos Electric #230	1/3	6,995,000.00	12/31/18	9.461%	9.352% qtr.
*South Texas Electric #200	1/3	230,000.00	12/31/18	9.461%	9.352% qtr.
*Wabash Valley Power #206	1/6	29,911,000.00	1/6/88	8.165%	8.083% qtr.
*Northwest Electric #176	1/6	775,000.00	1/6/88	8.165%	8.083% qtr.
*Corn Belt Power #94	1/6	423,000.00	1/6/88	8.165%	8.083% qtr.
*Corn Belt Power #166	1/6	77,000.00	1/6/88	8.165%	8.083% qtr.
*Cajun Electric #180	1/6	58,500,000.00	12/31/16	9.484%	9.374% qtr.
*Basin Electric #137	1/9	25,000,000.00	1/11/88	8.215%	8.132% qtr.
*Wolverine Power #101	1/10	1,725,000.00	3/31/88	8.448%	8.361% qtr.
*So. Mississippi Electric #171	1/13	15,000,000.00	12/31/20	9.708%	9.593% qtr.
*So. Mississippi Electric #289	1/13	3,973,000.00	12/31/18	9.717%	9.602% qtr.
*Soyland Power #165	1/13	4,385,000.00	12/31/16	9.722%	9.607% qtr.
*Wabash Valley Power #104	1/13	3,453,000.00	1/13/88	8.485%	8.397% qtr.
*Wabash Valley Power #206	1/13	11,896,000.00	1/13/88	8.485%	8.397% qtr.
*Wabash Valley Power #206	1/13	2,292,000.00	1/13/88	8.485%	8.397% qtr.
*Wolverine Power #182	1/13	2,203,000.00	1/11/89	8.745%	8.651% qtr.
*Wolverine Power #183	1/13	2,813,000.00	1/11/89	8.745%	8.651% qtr.
*Western Farmers Electric #133	1/13	2,631,000.00	12/31/18	9.715%	9.600% qtr.
*Western Farmers Electric #220	1/13	57,000.00	12/31/18	9.715%	9.600% qtr.
*French Broad Electric #245	1/13	226,000.00	1/13/88	8.485%	8.397% qtr.

+rollover
*maturity extension

FEDERAL FINANCING BANK

JANUARY 1986 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
New Hampshire Electric #270	1/15	$ 642,000.00	1/2/18	9.734%	9.618% qtr.
*New Hampshire Electric #192	1/16	1,115,000.00	12/31/18	9.607%	9.494% qtr.
*Western Illinois Power #99	1/16	4,859,000.00	12/31/14	9.629%	9.516% qtr.
*Western Illinois Power #225	1/16	13,803,000.00	12/31/18	9.607%	9.494% qtr.
*East Kentucky Power #188	1/21	3,732,000.00	1/3/17	9.583%	9.471% qtr.
*So. Mississippi Electric #90	1/21	750,000.00	12/31/12	9.494%	9.384% qtr.
*Western Illinois Power #162	1/21	9,509,000.00	1/3/17	9.583%	9.471% qtr.
*Western Farm Electric #133	1/21	7,400,000.00	1/3/17	9.583%	9.471% qtr.
*Central Power #278	1/21	158,000.00	3/31/88	8.389%	8.303% qtr.
Sugarland Telephone Co. #210	1/22	4,314,000.00	12/31/20	9.568%	9.456% qtr.
Tri-State G&T #250	1/22	3,490,000.00	12/31/20	9.568%	9.456% qtr.
Oglethorpe Power #246	1/23	24,257,000.00	12/31/20	9.627%	9.514% qtr.
Associated Electric #132	1/23	17,413,000.00	12/31/20	9.627%	9.514% qtr.
*Wolverine Power #101	1/23	167,000.00	3/31/88	8.377%	8.291% qtr.
*Colorado Ute Electric #96	1/23	1,145,000.00	1/25/88	8.315%	8.230% qtr.
*East Kentucky Power #140	1/23	360,000.00	1/3/17	9.644%	9.530% qtr.
*Basin Electric #137	1/23	25,000,000.00	1/3/17	9.644%	9.530% qtr.
*Dairyland Power #54	1/23	1,400,000.00	12/31/14	9.657%	9.543% qtr.
*Sunflower Electric #174	1/23	6,000,000.00	1/25/88	8.315%	8.230% qtr.
Vermont Electric #311	1/24	1,376,480.00	1/2/18	9.591%	9.479% qtr.
*Brazos Electric #108	1/27	468,000.00	1/3/17	9.621%	9.508% qtr.
*Brazos Electric #144	1/27	1,379,000.00	1/3/17	9.621%	9.508% qtr.
*Colorado Ute Electric #196	1/27	1,810,000.00	1/27/88	8.265%	8.181% qtr.
Corn Belt Power #292	1/28	311,000.00	1/2/18	9.518%	9.407% qtr.
*Washington Electric #269	1/29	2,126,829.26	12/31/14	9.438%	9.329% qtr.
North Carolina Electric #268	1/30	4,813,000.00	1/2/18	9.481%	9.371% qtr.
*Wabash Valley Power #206	1/30	134,000.00	2/1/88	8.185%	8.103% qtr.
*Dairyland Power #54	1/30	1,465,000.00	1/30/89	8.435%	8.348% qtr.
*Southern Illinois Power #38	1/31	300,000.00	3/31/88	8.208%	8.125% qtr.
*East Kentucky Power #140	1/31	3,666,000.00	12/31/14	9.498%	9.388% qtr.
*Corn Belt Power #94	1/31	300,000.00	12/31/14	9.498%	9.388% qtr.
*Corn Belt Power #138	1/31	229,000.00	12/31/18	9.501%	9.391% qtr.
*Plains Electric #158	1/31	2,866,000.00	12/31/18	9.501%	9.391% qtr.
*Saluda River Electric #186	1/31	1,106,000.00	12/31/18	9.501%	9.391% qtr.
*Allegheny Electric #175	1/31	1,838,000.00	12/31/15	9.397%	9.289% qtr.
Kamo Electric #266	1/31	5,014,000.00	12/31/15	9.516%	9.405% qtr.
Tex-La Electric #208	1/31	1,130,000.00	12/31/20	9.502%	9.392% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
Texas Panhandle Reg. Dev. Corp.	1/8	50,000.00	1/1/01	9.199%	
Texas Panhandle Reg. Dev. Corp.	1/8	113,000.00	1/1/01	9.199%	
Alabama Community Dev. Corp.	1/8	119,000.00	1/1/01	9.199%	
San Diego County L.D.C.	1/8	122,000.00	1/1/01	9.199%	
Small Enterprise Dev. Co.	1/8	149,000.00	1/1/01	9.199%	
Ozark Gateway Dev., Inc.	1/8	166,000.00	1/1/01	9.199%	
Commonwealth Sm. Bus. Dev. Corp	1/8	168,000.00	1/1/01	9.199%	
Central California C.D. Corp.	1/8	179,000.00	1/1/01	9.199%	
Rural Missouri, Inc.	1/8	179,000.00	1/1/01	9.199%	
Greater Pocatello Dev. Corp.	1/8	182,000.00	1/1/01	9.199%	
Oregon Cert. Bus. Dev. Corp.	1/8	224,000.00	1/1/01	9.199%	
Tulare County Ec. Dev. Corp.	1/8	236,000.00	1/1/01	9.199%	
Commonwealth Sm. B.D.C.	1/8	242,000.00	1/1/01	9.199%	
Clay County Dev. Corp.	1/8	281,000.00	1/1/01	9.199%	
Eastern Maine Dev. District	1/8	294,000.00	1/1/01	9.199%	
Mid-City Pioneer Corp.	1/8	350,000.00	1/1/01	9.199%	
Community D.C. of Ft. Wayne	1/8	355,000.00	1/1/01	9.199%	
Ocean State B.D. Auth., Inc.	1/8	373,000.00	1/1/01	9.199%	
Wisconsin Bus. Dev. Fin. Corp.	1/8	383,000.00	1/1/01	9.199%	
Rural Missouri, Inc.	1/8	427,000.00	1/1/01	9.199%	
Eastern Maine Dev. District	1/8	498,000.00	1/1/01	9.199%	

*maturity extension

FEDERAL FINANCING BANK

JANUARY 1986 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
State & Local Development Company Debentures (Cont'd)					
Urban Bus. Dev. Corp.	1/8	$ 42,000.00	1/1/06	9.413%	
Union County Ec. Dev. Corp.	1/8	54,000.00	1/1/06	9.413%	
St. Louis Local Dev. Co.	1/8	55,000.00	1/1/06	9.413%	
CSRA Local Dev. Corp.	1/8	61,000.00	1/1/06	9.413%	
Alabama Community D.C.A., Inc.	1/8	66,000.00	1/1/06	9.413%	
St. Louis Local Dev. Co.	1/8	71,000.00	1/1/06	9.413%	
Big Lakes C. D. Co.	1/8	83,000.00	1/1/06	9.413%	
Cambridge Ec. Dev. Corp.	1/8	84,000.00	1/1/06	9.413%	
St. Louis Local Dev. Co.	1/8	84,000.00	1/1/06	9.413%	
Charlotte C. D. Corp.	1/8	99,000.00	1/1/06	9.413%	
Historic 25th St. Dev. Co.	1/8	99,000.00	1/1/06	9.413%	
E. C. I. A. Bus. Growth, Inc.	1/8	100,000.00	1/1/06	9.413%	
St. Louis Local Dev. Co.	1/8	108,000.00	1/1/06	9.413%	
Crater Dev. Co.	1/8	109,000.00	1/1/06	9.413%	
Phoenix L. D. Corp.	1/8	122,000.00	1/1/06	9.413%	
San Diego County L. D. Corp.	1/8	122,000.00	1/1/06	9.413%	
Forward Dev. Corp.	1/8	158,000.00	1/1/06	9.413%	
Bus. Dev. Corp. of Nebraska	1/8	168,000.00	1/1/06	9.413%	
First District Dev. Co.	1/8	170,000.00	1/1/06	9.413%	
Economic Dev. Foundation	1/8	208,000.00	1/1/06	9.413%	
Pecan Valley Ec. Dev. District	1/8	223,000.00	1/1/06	9.413%	
Greater Salt Lake Bus. Dis.	1/8	224,000.00	1/1/06	9.413%	
Georgia Mountains Reg. E.D.C.	1/8	231,000.00	1/1/06	9.413%	
Texas C. D. Co., Inc.	1/8	233,000.00	1/1/06	9.413%	
Mahoning Valley Ec. Dev. Corp.	1/8	240,000.00	1/1/06	9.413%	
Crossroads EDC of St. Charles	1/8	250,000.00	1/1/06	9.413%	
Ocean State Bus Dev Auth, Inc	1/8	252,000.00	1/1/06	9.413%	
St. Louis County L. D. C.	1/8	252,000.00	1/1/06	9.413%	
Gr. Salt Lake Bus. District	1/8	255,000.00	1/1/06	9.413%	
N. Puerto Rico L. D. Co., Inc.	1/8	280,000.00	1/1/06	9.413%	
S.W. Michigan Dev. Co., Inc.	1/8	300,000.00	1/1/06	9.413%	
St. Louis County L.D.C.	1/8	312,000.00	1/1/06	9.413%	
S. Cen. Kansas E.D. Dis., Inc.	1/8	323,000.00	1/1/06	9.413%	
Gr. Kenosha Dev. Corp.	1/8	330,000.00	1/1/06	9.413%	
Texas Cert. Dev. Co., Inc.	1/8	331,000.00	1/1/06	9.413%	
Phoenix L. D. Corp.	1/8	379,000.00	1/1/06	9.413%	
Empire State C.D. Corp.	1/8	500,000.00	1/1/06	9.413%	
Columbus Countywide Dev. Corp.	1/8	48,000.00	1/1/11	9.507%	
Union County Ec. Dev. Corp.	1/8	52,000.00	1/1/11	9.507%	
Treasure Valley C. D. Corp.	1/8	53,000.00	1/1/11	9.507%	
East Texas Reg. Dev. Co.	1/8	70,000.00	1/1/11	9.507%	
Union County Ec. Dev. Corp.	1/8	71,000.00	1/1/11	9.507%	
Columbus Countywide Dev. Corp.	1/8	82,000.00	1/1/11	9.507%	
Columbus Countywide Dev. Corp.	1/8	84,000.00	1/1/11	9.507%	
Hamilton County Dev. Co., Inc.	1/8	99,000.00	1/1/11	9.507%	
Evergreen Community Dev. Assoc.	1/8	105,000.00	1/1/11	9.507%	
Alabama Community Dev. Corp.	1/8	113,000.00	1/1/11	9.507%	
Corp. for B.A. in New Jersey	1/8	126,000.00	1/1/11	9.507%	
San Diego County LDC	1/8	128,000.00	1/1/11	9.507%	
Treasure Valley C. D. Corp.	1/8	135,000.00	1/1/11	9.507%	
Neuse River Dev. Auth., Inc.	1/8	142,000.00	1/1/11	9.507%	
Economic Dev. Foundation	1/8	146,000.00	1/1/11	9.507%	
River East Progress, Inc.	1/8	165,000.00	1/1/11	9.507%	
Evergreen Community Dev. Assoc.	1/8	180,000.00	1/1/11	9.507%	
Fulton County C. D. Corp.	1/8	194,000.00	1/1/11	9.507%	
Wilmington Indus. Dev., Inc.	1/8	197,000.00	1/1/11	9.507%	
Metro Area Dev. Corp.	1/8	210,000.00	1/1/11	9.507%	
Nevada State Dev. Corp.	1/8	248,000.00	1/1/11	9.507%	
MSP 503 Dev. Corp.	1/8	270,000.00	1/1/11	9.507%	
Verd-Ark-Ca Dev. Corp.	1/8	271,000.00	1/1/11	9.507%	
Bay Area Bus. Dev. Co.	1/8	272,000.00	1/1/11	9.507%	
Clark County Dev. Corp.	1/8	278,000.00	1/1/11	9.507%	
Community E.D.C. of Colorado	1/8	307,000.00	1/1/11	9.507%	

FEDERAL FINANCING BANK

JANUARY 1986 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
State & Local Development Company Debentures (Cont'd)					
Bay Area Bus. Dev. Co.	1/8	$ 326,000.00	1/1/11	9.507%	
Nevada St. Dev. Corp.	1/8	334,000.00	1/1/11	9.507%	
South Dakota Dev. Corp.	1/8	343,000.00	1/1/11	9.507%	
Nevada St. Dev. Corp.	1/8	389,000.00	1/1/11	9.507%	
E.D.F. of Sacramento, Inc.	1/8	470,000.00	1/1/11	9.507%	
St. Louis Local Dev. Co.	1/8	500,000.00	1/1/11	9.507%	
McIntosh Trail Area Dev. Corp.	1/8	500,000.00	1/1/11	9.507%	
Bay Area Business Dev. Co.	1/8	500,000.00	1/1/11	9.507%	
Small Business Investment Company Debentures					
Falcon Capital Corp.	1/22	500,000.00	1/1/91	8.855%	
BT Capital Corp.	1/22	5,000,000.00	1/1/96	9.365%	
CMNY Capital Company, Inc.	1/22	900,000.00	1/1/96	9.365%	
Heritage Capital Corp.	1/22	1,000,000.00	1/1/96	9.365%	
Orange Nassau Capital Corp.	1/22	1,000,000.00	1/1/96	9.365%	
Seaport Ventures, Inc.	1/22	1,000,000.00	1/1/96	9.365%	
Vadus Capital Corporation	1/22	1,000,000.00	1/1/96	9.365%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
+Note A-86-04	1/31	488,992,522.31	4/30/86	7.385%	

+rollover

FEDERAL FINANCING BANK
JANUARY 1986 Commitments

BORROWER	GUARANTOR	AMOUNT	COMMITMENT EXPIRES	MATURITY
Ponce, PR	HUD	$ 2,297,923.00	8/1/86	8/1/86
Cincinnati, OH	HUD	1,171,000.00	12/1/88	12/1/03
Omaha, NE	HUD	350,000.00	12/1/86	12/1/86
Florence, SC	HUD	1,100,000.00	7/1/87	7/1/87

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	January 31, 1986	December 31, 1985	Net Change 1/1/86-1/31/86	Net Change--FY 1986 10/1/85-1/31/86
Agency Debt				
Export-Import Bank	$ 15,670.3	$ 15,670.3	$ -0-	$ 261.3
NCUA-Central Liquidity Facility	225.2	223.2	2.0	3.0
Tennessee Valley Authority	14,690.0	14,622.0	68.0	309.0
U.S. Postal Service	1,690.0	1,690.0	-0-	-0-
U.S. Railway Association	73.8	73.8	-0-	-0-
Agency Assets				
Farmers Home Administration	64,354.0	64,234.0	120.0	185.0
DHHS-Health Maintenance Org.	105.9	105.9	-0-	-3.3
DHHS-Medical Facilities	122.1	122.8	-0.7	-0.7
Overseas Private Investment Corp.	3.4	4.0	-0.6	-2.7
Rural Electrification Admin.-CBO	3,724.3	3,724.3	-0-	-0-
Small Business Administration	30.5	31.2	-0.7	-2.5
Government-Guaranteed Lending				
DOD-Foreign Military Sales	18,391.3	18,306.3	85.0	302.7
DEd.-Student Loan Marketing Assn.	5,000.0	5,000.0	-0-	-0-
DHUD-Community Dev. Block Grant	281.1	275.4	5.7	-8.2
DHUD-New Communities	32.2	33.5	-1.3	-1.3
DHUD-Public Housing Notes	2,111.4	2,111.4	-0-	-34.7
General Services Administration	405.3	405.3	-0-	-3.1
DOI-Guam Power Authority	35.1	35.1	-0-	-0-
DOI-Virgin Islands	27.8	28.2	-0.4	-0.4
NASA-Space Communications Co.	887.6	887.6	-0-	-0-
DON-Ship Lease Financing	1,426.0	1,431.0	-5.0	112.9
DON-Defense Production Act	7.1	6.6	0.5	1.3
Oregon Veteran's Housing	60.0	60.0	-0-	-0-
Rural Electrification Admin.	20,677.5	20,653.8	23.7	-998.0
SBA-Small Business Investment Cos.	1,050.2	1,041.9	8.4	26.3
SBA-State/Local Development Cos.	674.7	656.5	18.2	79.0
TVA-Seven States Energy Corp.	1,709.8	1,696.4	13.4	58.4
DOT-Section 511	65.7	65.7	-0-	-87.9
DOT-WMATA	177.0	177.0	-0-	-0-
TOTALS*	$ 153,709.3	$ 153,373.2	$ 336.1	$ 196.1

*figures may not total due to rounding

TREASURY NEWS

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

12 9 22 AM '86

DEPARTMENT OF THE TREASURY

FOR RELEASE AT 12:00 NOON

March 7, 1986

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $9,000 million of 364-day Treasury bills to be dated March 20, 1986, and to mature March 19, 1987 (CUSIP No. 912794 MB 7). This issue will provide about $475 million of new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $8,529 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Thursday, March 13, 1986.

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.

The bills will be issued for cash and in exchange for Treasury bills maturing March 20, 1986. In addition to the maturing 52-week bills, there are $14,861 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 currently hold $1,999 million as agents for foreign and international monetary authorities, and $5,751 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rate 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 $200 million of the original 52-week issue. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-1.

B-493

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, 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

LIBRARY, ROOM 5310

FOR IMMEDIATE RELEASE March 10, 1986

MAR 13 9 23 AM '86
DEPT. OF THE TREASURY

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,809 million of 13-week bills and for $6,840 million of 26-week bills, both to be issued on March 13, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 12, 1986			26-week bills maturing September 11, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	6.54%	6.74%	98.347	6.54%	6.86%	96.694
High	6.55%	6.75%	98.344	6.54%	6.86%	96.694
Average	6.55%	6.75%	98.344	6.54%	6.86%	96.694

Tenders at the high discount rate for the 13-week bills were allotted 96%.
Tenders at the high discount rate for the 26-week bills were allotted 65%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 32,395	$ 32,395	$ 30,515	$ 30,515
New York	21,526,635	6,016,235	22,466,350	6,073,980
Philadelphia	330,625	30,625	16,880	16,880
Cleveland	41,195	37,160	50,995	25,995
Richmond	112,975	40,475	42,625	31,625
Atlanta	43,565	39,965	30,600	30,450
Chicago	1,615,030	54,530	1,557,445	60,445
St. Louis	84,035	54,425	77,605	49,605
Minneapolis	40,510	15,400	37,140	12,140
Kansas City	56,320	56,320	46,190	46,190
Dallas	40,015	30,015	30,540	20,540
San Francisco	1,347,345	78,275	885,520	52,100
Treasury	323,150	323,150	389,600	389,600
TOTALS	$25,593,795	$6,808,970	$25,662,005	$6,840,065
Type				
Competitive	$22,360,645	$3,575,820	$22,307,560	$3,485,620
Noncompetitive	1,049,820	1,049,820	901,845	901,845
Subtotal, Public	$23,410,465	$4,625,640	$23,209,405	$4,387,465
Federal Reserve	1,835,730	1,835,730	1,750,000	1,750,000
Foreign Official Institutions	347,600	347,600	702,600	702,600
TOTALS	$25,593,795	$6,808,970	$25,662,005	$6,840,065

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
March 12, 1986

STATEMENT OF THE HONORABLE
JAMES A. BAKER, III
SECRETARY OF THE TREASURY

BEFORE THE
SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE
COMMITTEE ON APPROPRIATIONS
U.S. SENATE
MARCH 12, 1986

Mr. Chairman and members of the committee:

I welcome this opportunity to discuss with you the Administration's budgetary proposals for the Multilateral Development Banks (MDBs) for fiscal year 1987.

Since taking office, the Administration has stressed the importance of sound, market-oriented policies to achieving economic development. Today, I would like to review this issue; to discuss its importance in the Administration's initiative to encourage growth in many developing countries now contending with high debt service payments; and to stress the cost effectiveness of MDB operations.

Program for Sustained Growth

Last October at the annual meetings of the World Bank and IMF, I outlined a U.S. proposal for addressing the problems of debt ridden developing countries -- the "Program for Sustained Growth". This three-point program aimed at improving debtors' growth prospects builds on the current case-by-case debt strategy and involves the following elements:

(1) credible policy reform by the debtor nations;

(2) an enhanced role for the international financial institutions, particularly the World Bank; and,

(3) significant net new lending from the commercial banks.

Stronger and sustainable growth in the debtor countries is essential to solving the debt problem. Achieving this objective, however, requires recognition by the debtor countries themselves of the need to adopt growth-oriented

economic policies. Absent appropriate economic policies, no amount of money -- whether derived from external borrowing, foreign aid, or domestic monetary expansion -- will produce sustained growth.

The types of policies required for stronger and sustainable growth are:

-- the privatization of burdensome and inefficient public enterprises,

-- the development of more efficient domestic capital equity markets,

-- growth oriented tax reform,

-- improvement of the environment for both domestic and foreign direct investment, and

-- trade liberalization and the rationalization of import regimes.

Many of these touch sensitive political issues, and their benefits may become visible only over the longer term.

Role of the MDBs. The MDBs, in particular the World Bank and the Inter-American Development Bank (IDB), are expected to play a central role in this initiative. We have also asked the IMF to give more thought to growth-oriented policies and this is being done. But the IMF's central mission is not that of a development institution. It concentrates on relatively short-term balance of payments programs. Hence, the Fund's contribution to longer-term reform efforts is necessarily somewhat limited and indirect. The MDBs on the other hand, are more strongly focused on longer-term development issues, and thus are in a better position to deal with the longer-term structural problems most debtor countries face.

The expanded role for the MDBs that this Program foresees, in particular the roles of the World Bank and the IDB, will also require important policy and procedural changes in these institutions. These changes may be difficult but are indispensable if these institutions are to significantly expand their policy-based, fast-disbursing lending.

For example, it will be essential to improve and strengthen conditionality. Any substantial increase in fast-disbursing lending which fails to maintain loan quality will result in a serious risk of over-exposure and a diminished international credit standing.

The World Bank already has experience in addressing some of the types of structural problems that most debtor countries face. Much of the World Bank's new lending will be fast-disbursing sectoral and structural adjustment loans. We believe the World Bank has ample capacity to increase lending commitments by some $2 billion per year over the next three years and to concentrate that lending more heavily on the large debtors with credible reform programs. We are also prepared, if all the participants in the strategy do their part and there is a demonstrated increase in the demand for quality lending above these levels, to consider a general capital increase for the World Bank.

In this context our ongoing and past efforts to strengthen MDB policies take on an ever great importance.

Strengthen Economic Policies

From the outset this Administration has emphasized that a fundamental role of the MDBs should be to encourage policy reform in developing countries. This was a central theme of the Administration's assessment of the MDBs, published in 1982. This general theme, which we have emphasized with the MDBs and with the major donor countries, is translated into four main areas:

-- improved loan quality
-- privatization
-- country strategies, and
-- adjustment in lending terms.

Loan Quality

We have had a measure of success in our continuing efforts to improve loan quality. We have pushed the MDBs to focus more on how overall macroeconomic policies impact on projects, and they have responded by broadening their examination to include all of the variables in the economy, e.g., interest rates and exchange rates, not just those traditionally in their preview -- e.g., user charges and farm-gate prices.

Our chief concern now is that too often the MDBs yield to borrower intransigence on improving loan quality issues. For instance, an unwillingness to rationalize uneconomic public utility rates or import tariffs. This is particularly true toward the end of a fiscal year when the question becomes one of making a loan or not. We want a greater resolve by the MDBs to seek strong, economic loan conditions; and an increased willingness by the MDBs to refuse funding when these conditions are not accepted, or, once accepted, are not met.

Private Sector

The MDBs are doing much more to promote the private sector. The Asian Development Bank (ADB) established a private sector unit, which has started a limited program of lending to the private sector without guarantees. The World Bank has been in the forefront in convincing governments, particularly in Africa, to restrict their role in the economy. Overall, the MDBs are focusing more on the private sector. Now the Administration wants each of the MDBs to enhance their operations to promote private sector development, i.e., to devise ways to emphasize the private sector in preference to the public sector. Possibilities include intermediating loans between the foreign and domestic private sector, having parastatal enterprises become more responsive to market forces, and where appropriate, selling off all or part of the state's interest.

We recognize there are honest differences of opinion regarding the role of the state in some sectors of the economy -- such as utilities and telephone service. But we cannot allow these unique sectors to obscure the fact that in most industries, government ownership is disruptive, inefficient, and is not required. In our opinion, the MDBs must confront these cases head-on.

Country Strategy

All of the MDBs produce lending plans for borrowing countries that set out to varying degrees the resource base and the policies -- taxing, pricing, regulations, investment climate, etc. -- which will best exploit market opportunities in those countries. Too often, however, there is an insufficient connection between country strategy documents and lending. We believe country strategies must serve as a broad guideline in the preparation of individual loans, and should not be undermined. Better coordination on country strategies between the MDBs, bilateral donors and borrowers is needed. In particular, country strategies must be worked out thoroughly with the developing countries to have their full support -- without their support this will not work.

Lending Terms

Finally, we are suggesting moderate changes in concessional lending terms. This includes a reduction of maturities and grace periods, repricing during a loan to reflect changes in a borrower's economic circumstances, and establishment of a small interest charge. Other donor countries have been generally supportive of our desires to reduce maturities and grace periods, and to provide for repricing of future loan contracts.

However, they are strongly resisting our request to charge modest interest rates. We will continue our discussion on these issues with other donors during the course of the ongoing replenishment negotiations.

The Multilateral Investment Guarantee Agency (MIGA)

Consistent with these efforts to strengthen economic policy, the Administration has supported the creation of the Multilateral Investment Guarantee Agency (MIGA), and is requesting Congressional support and approval of the MIGA. The MIGA will promote reform of developing countries investment policies, enhance the private sector's contribution to the development process, and encourage the flow of non-debt capital to developing countries. Its strong mandate to promote policy reform in developing member countries will be a valuable addition to the programs we are using to promote policy reform through the multilateral development banks. In addition, by stimulating the flow of private direct investment to developing countries, the MIGA can be an important component in our international debt strategy by furthering our objective to enhance the role of the private sector in developing countries and the movement toward equity vs. debt capital in these countries.

U.S. membership in the MIGA will also advance our national interests. The United States, as the largest international investor, has a major stake in seeing that appropriate standards for investment protection are developed. Due to its multilateral nature, the MIGA will be better positioned to promote reforms than OPIC or other national insurance agencies, which focus on individual transactions to increase the competitiveness of their investors. This will be a small, cost effective operation requiring little funding. In return we will secure an important new instrument for promoting an improved international economy.

Thus, the Administration believes that the United States should move expeditiously to join the MIGA and seeks authorization and full funding of U.S. membership in the FY 1987 Budget. The $222.0 million U.S. subscription -- which is 20.5 percent of the total -- will include $44.4 million of budget authority of which $22.2 million is to be paid in cash and $22.2 million is to be in the form of non-negotiable non-interest bearing promissory notes. The remainder of the Administration's request is for $177.6 million of callable capital under program limitations. I want to emphasize that this is a one year appropriation; we do not envisage additional budget requests.

The MIGA will be a valuable addition to the multilateral institutions because it is uniquely positioned to further our policies toward development in developing countries as well as serve our own economic interests. Support for its creation comes not only

from the Administration; it has also attracted broad endorsement from the private sector. I therefore urge that the Congress enable us to move expeditiously to become a founding member of the MIGA.

Environment

Mr. Chairman, another critical area of interest regarding MDB policies and operations is the environment. You have expressed concern about the negative impact of some MDB projects on the environment. The Treasury Department has found that MDB performance in this area is mixed, and has expressed its concern in meetings with senior management at the MDBs, and with other member countries. Major problems have surfaced in such projects as dams, penetration roads into relatively undeveloped areas, and agriculture and rural development. Too often, if environmental considerations threaten expeditious project financing, the environment is assigned low priority and is left to be dealt with later. We believe projects in environmentally sensitive sectors should only be accepted if environmental aspects have been thought through, and if measures necessary for sustainable development have been identified and any necessary funding assured. We are carrying out the requirements which you placed in the FY 1986 appropriation act and will be responding to you in detail in the near future.

Cost Effectiveness of the MDBs

It is important to emphasize that while we are seeking changes in the MDBs, they are very important to the conduct of U.S. foreign and economic policy; and they are performing better. Hence, it is in our own self-interest to assure they are adequately funded.

The cost to the United States of trying to duplicate bilaterally what has been achieved multilaterally in the MDBs would be prohibitive. Through 1984 the MDB hard loan windows have made total loan commitments of $133.1 billion at a cost to the United States of only $2.4 billion. The soft, concessional loan windows have made $50.6 billion in loan commitments at a cost to U.S. taxpayers of $14.8 billion. As we have pointed out previously, most of the countries that receive allocations from the State Department's Economic Support Fund (ESF) also receive MDB support. Three countries that receive ESF but no MDB assistance -- Israel, Italy, and Spain -- have per capita incomes too high to qualify as MDB borrowers. Interestingly, there are a number of countries of strategic importance to the United States -- e.g., Argentina, Brazil, and Mexico -- that receive substantial MDB support, but no ESF at all.

It is true that MDB programs do not always live up to the high standards we and the MDBs themselves have set. That is why we are trying to exercise our leadership in directing how the

MDBs can improve their operations. Through our leadership we have been seeing a better product. However, we can only maintain our leadership position if we are willing to bear what the other members mutually perceive to be our fair share in supporting these institutions. We cannot have it both ways, i.e., we cannot for long place more of the burden of fostering and enlarging the international economic system on the MDBs and other international organizations, and then refuse to support them adequately.

Currently we are negotiating replenishments with all of the MDB groups. We have been consulting with the Congress regularly during these negotiations to ensure we are taking into account your views. We will continue these consultations as the negotiations proceed.

These replenishments and aspects of the U.S. debt initiative indicate a potential need for increased resources for the MDBs which is at variance with our current budget environment. The Administration's fiscal year 1986 request for the MDBs was reduced by $228.8 million by Congress in the Continuing Resolution; implementing Gramm-Rudman-Hollings reduced it another $48.1 million. The funding requests reflect a commitment on the part of the United States Government. We have an obligation to our friends and allies to honor these commitments. We will be seeking your support for appropriating these shortfalls.

We are currently discussing with the Department of State and OMB how best to handle these shortfalls in MDB funding. I would urge your support in this effort and ask that you not compound the problem with additional reductions in the FY 1987 budget request for the MDBs.

The Fiscal Year 1987 Budget Request

Our MDB fiscal year 1987 request is composed almost exclusively of funding requirements negotiated by this Administration in close consultation with this Committee.

These funding proposals reflect both the need for budgetary restraint and the financial requirements for effective development programs. The fiscal year 1987 request is for $1.4 billion in budget authority and $3.8 billion under program limitations for callable capital.

International Bank for Reconstruction and Development (IBRD)

For the IBRD in fiscal year 1987, the Administration is requesting: 1) $109.7 million in budget authority and $1,353.0 million under program limitations for subscriptions to the sixth installment of the 1981 GCI; 2) $65.7 million in budget

authority and $685.5 million under program limitations for subscriptions to the first of two installments to the IBRD's 1984 Selective Capital Increase (SCI); and 3) $7.4 million for paid-in capital subscriptions and $66.7 million in program limitations for callable capital subscriptions to the 1970 SCI.

The 1984 SCI totals $8.4 billion and was unanimously approved by the IBRD Executive Board in May 1984. This SCI adjusts members' relative shares to reflect their relative position in the world economy. U.S. participation is the parameter of U.S. support for the World Bank and our willingness to work cooperatively with other donor countries to strengthen the World Bank's financial position and ensure improved cost-sharing.

The Administration continues to believe that the IBRD should play a prominent role in the longer-term development programs of its borrowers and regards "equitable cost-sharing" among donors to be a key element of our participation in all of the MDBs. An important consideration for the United States in negotiating the SCI was the general understanding to maintain a conservative interpretation of the IBRD's "sustainable level of lending" (SLL).

International Development Association (IDA)

For fiscal year 1987, the Administration is requesting $750 million for the third installment for the $2.25 billion U.S. share of the $9 billion Seventh Replenishment. We are pleased at the speed with which the World Bank has moved, with full support of the Executive Board, to strengthen the administration and management of its African operations, with the object of supporting policy reform efforts in this region. We continue to believe the countries of Sub-Saharan Africa and other least developed countries should have first claim on available IDA resources as long as these countries are able to make effective use of these resources.

International Finance Corporation (IFC)

For fiscal year 1987, the Administration is seeking $35.0 million for the second of five installments on the U.S. subscription to a $650 million IFC capital increase unanimously approved by the IFC Executive Board in June 1984.

This capital increase is needed to support an IFC five-year plan for the period FY 1985-1989 that is consistent with the direction and emphasis the United States has encouraged the IFC to take.

Multilateral Investment Guarantee Agency (MIGA)

As mentioned above, for fiscal year 1987, the Administration is requesting $44.4 million in budget authority and $177.6 million under program limitations for the U.S. subscription. Of the budget authority, half ($22.2 million) will be paid in cash and half will be in the form of non-negotiable, non-interest bearing promissory notes that will be treated like callable capital.

The MIGA is a new international institution designed to encourage the flow of investment to and among developing countries by issuing guarantees against political risk, carrying out a wide range of promotional activities and encouraging sound investment policies in member countries. Foreign direct investment, which the MIGA will accelerate, can be a direct substitute for official financial flows. The Administration has strongly supported the creation of this institution and believes that the United States should move expeditiously to join it.

Inter-American Development Bank (IDB)

For fiscal year 1987, the Administration is requesting $58.0 million in budget authority and $1,231.0 million under program limitations for the fourth installment. The lending program based on the 1983 capital increase is designed to continue strong support for the long term development of the countries in Latin America and the Caribbean.

Fund for Special Operations (FSO)

For fiscal year 1987, the Administration is requesting $72.5 million for the fourth installment. The FSO replenishment is designed to address the long term development needs of the poorest countries, primarily in Central America and the Caribbean.

Inter-American Investment Corporation (IIC)

For fiscal year 1987, the Administration is seeking $13 million for the third of four installments to the IIC. The Administration strongly supported establishing the IIC as a practical means of enhancing the capacity of the IDB to aid the private sector in borrowing countries. The investment program will provide loans and equity participation for small- to medium-sized privately controlled firms in Latin America and the Caribbean.

Asian Development Bank (ADB)

For fiscal year 1987, the Administration is seeking $13.2 million in budget authority and $251.4 million under program limitations for the fourth of five installments for the 1983

General Capital Increase. The ADB is a key institution in one of the most economically dynamic and politically sensitive regions of the world. Active and positive U.S. participation has served U.S. interests.

Asian Development Fund (ADF)

For fiscal year 1987, the Administration is requesting $130 million for the fourth installment to the third replenishment. The ADF has supported well designed and effective development projects in some of the poorest countries in the world. U.S. support benefits the people of such countries as Pakistan and Sri Lanka as well as many of the strategic island countries in the South Pacific.

African Development Bank (AFDB)

For fiscal year 1987, the Administration is requesting $18.0 million in budget authority for subscriptions to paid-in capital and $54.0 million under program limitations for callable capital for the fifth of five installments for the initial U.S. subscription to the AFDB.

The AFDB is visible evidence of U.S. commitment to work with the countries of Africa for the achievement of their long term development objectives.

African Development Fund (AFDF)

For fiscal year 1987, the Administration is seeking $75 million in budget authority for the second of three installments for the U.S. contribution to the fourth replenishment. During the period of the fourth replenishment, 85 percent of AFDF lending will go to the poorest African countries. Fund lending will continue to be focused on agriculture with 40 percent of the replenishment resources going to this sector. The remainder of AFDF lending will go to high priority projects for transportation, health, education and water supply.

The substantial increase in the U.S. contribution to the AFDF is a reflection of the Administration's belief that concessional development assistance should be focused on the poorest countries, particularly those of Sub-Saharan Africa.

Conclusion

In conclusion, Mr. Chairman, I want to emphasize the Administration's commitment and full support for the MDBs. They play an important role in U.S. foreign and international economic policy. Now, we are asking them to take a more active part in supporting growth-oriented policy reform in the developing countries -- to play a central role in implementing the

"Program for Sustained Growth". Successful implementation of this program will be very helpful to the U.S. economy, it will increase effective demand among developing countries for U.S. exports; and will reduce the strains on the international financial system by helping developing countries reduce their debt service obligations to more manageable proportions.

I recognize fully that even in the best of circumstances supporting foreign assistance is never popular. Now, at a time of severe budget constraint, it will be even more difficult. But I strongly believe that if we do not firmly support the MDBs now, we may have to resort to more costly measures later.

TREASURY NEWS

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

LIBRARY, ROOM 5310

FOR RELEASE AT 4:00 P.M.

March 11, 1986

TREASURY'S WEEKLY BILL OFFERING

MAR 13 9 23 AM '86
DEPT. OF THE TREASURY

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $13,600 million, to be issued March 20, 1986. This offering will result in a paydown for the Treasury of about $1,250 million, as the maturing bills are outstanding in the amount of $14,861 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Standard time, Monday, March 17, 1986. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,800 million, representing an additional amount of bills dated December 19, 1985, and to mature June 19, 1986 (CUSIP No. 912794 KL 7), currently outstanding in the amount of $7,624 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,800 million, to be dated March 20, 1986, and to mature September 18, 1986 (CUSIP No. 912794 LD 4).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing March 20, 1986. In addition to the maturing 13-week and 26-week bills, there are $8,529 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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 $1,844 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $2,044 million as agents for foreign and international monetary authorities, and $5,751 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

Department of the Treasury Circulars, Public Debt Series - Nos 26-76 and 27-76, Treasury's single bidder guidelines, and this notice prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars, guidelines, 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 THE HONORABLE
JAMES A. BAKER, III
SECRETARY OF THE TREASURY

BEFORE THE
SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE
COMMITTEE ON APPROPRIATIONS
U.S. HOUSE OF REPRESENTATIVES
MARCH 13, 1986

Mr. Chairman and members of the committee:

I welcome this opportunity to discuss with you the Administration's budgetary proposals for the Multilateral Development Banks (MDBs) for fiscal year 1987.

Since taking office, the Administration has stressed the importance of sound, market-oriented policies to achieving economic development. Today, I would like to review this issue; to discuss its importance in the Administration's initiative to encourage growth in many developing countries now contending with high debt service payments; and to stress the cost effectiveness of MDB operations.

Program for Sustained Growth

Last October at the annual meetings of the World Bank and IMF, I outlined a U.S. proposal for addressing the problems of debt ridden developing countries -- the "Program for Sustained Growth". This three-point program aimed at improving debtors' growth prospects builds on the current case-by-case debt strategy and involves the following elements:

(1) credible policy reform by the debtor nations;

(2) an enhanced role for the international financial institutions, particularly the World Bank; and,

(3) significant net new lending from the commercial banks.

Stronger and sustainable growth in the debtor countries is essential to solving the debt problem. Achieving this objective, however, requires recognition by the debtor countries themselves of the need to adopt growth-oriented

economic policies. Absent appropriate economic policies, no amount of money -- whether derived from external borrowing, foreign aid, or domestic monetary expansion -- will produce sustained growth.

The types of policies required for stronger and sustainable growth are:

-- the privatization of burdensome and inefficient public enterprises,

-- the development of more efficient domestic capital equity markets,

-- growth oriented tax reform,

-- improvement of the environment for both domestic and foreign direct investment, and

-- trade liberalization and the rationalization of import regimes.

Many of these touch sensitive political issues, and their benefits may become visible only over the longer term.

Role of the MDBs. The MDBs, in particular the World Bank and the Inter-American Development Bank (IDB), are expected to play a central role in this initiative. We have also asked the IMF to give more thought to growth-oriented policies and this is being done. But the IMF's central mission is not that of a development institution. It concentrates on relatively short-term balance of payments programs. Hence, the Fund's contribution to longer-term reform efforts is necessarily somewhat limited and indirect. The MDBs on the other hand, are more strongly focused on longer-term development issues, and thus are in a better position to deal with the longer-term structural problems most debtor countries face.

The expanded role for the MDBs that this Program foresees, in particular the roles of the World Bank and the IDB, will also require important policy and procedural changes in these institutions. These changes may be difficult but are indispensable if these institutions are to significantly expand their policy-based, fast-disbursing lending.

For example, it will be essential to improve and strengthen conditionality. Any substantial increase in fast-disbursing lending which fails to maintain loan quality will result in a serious risk of over-exposure and a diminished international credit standing.

The World Bank already has experience in addressing some of the types of structural problems that most debtor countries face. Much of the World Bank's new lending will be fast-disbursing sectoral and structural adjustment loans. We believe the World Bank has ample capacity to increase lending commitments by some $2 billion per year over the next three years and to concentrate that lending more heavily on the large debtors with credible reform programs. We are also prepared, if all the participants in the strategy do their part and there is a demonstrated increase in the demand for quality lending above these levels, to consider a general capital increase for the World Bank.

In this context our ongoing and past efforts to strengthen MDB policies take on an ever great importance.

Strengthen Economic Policies

From the outset this Administration has emphasized that a fundamental role of the MDBs should be to encourage policy reform in developing countries. This was a central theme of the Administration's assessment of the MDBs, published in 1982. This general theme, which we have emphasized with the MDBs and with the major donor countries, is translated into four main areas:

-- improved loan quality
-- privatization
-- country strategies, and
-- adjustment in lending terms.

Loan Quality

We have had a measure of success in our continuing efforts to improve loan quality. We have pushed the MDBs to focus more on how overall macroeconomic policies impact on projects, and they have responded by broadening their examination to include all of the variables in the economy, e.g., interest rates and exchange rates, not just those traditionally in their preview -- e.g., user charges and farm-gate prices.

Our chief concern now is that too often the MDBs yield to borrower intransigence on improving loan quality issues. For instance, an unwillingness to rationalize uneconomic public utility rates or import tariffs. This is particularly true toward the end of a fiscal year when the question becomes one of making a loan or not. We want a greater resolve by the MDBs to seek strong, economic loan conditions; and an increased willingness by the MDBs to refuse funding when these conditions are not accepted, or, once accepted, are not met.

Private Sector

The MDBs are doing much more to promote the private sector. The Asian Development Bank (ADB) established a private sector unit, which has started a limited program of lending to the private sector without guarantees. The World Bank has been in the forefront in convincing governments, particularly in Africa, to restrict their role in the economy. Overall, the MDBs are focusing more on the private sector. Now the Administration wants each of the MDBs to enhance their operations to promote private sector development, i.e., to devise ways to emphasize the private sector in preference to the public sector. Possibilities include intermediating loans between the foreign and domestic private sector, having parastatal enterprises become more responsive to market forces, and where appropriate, selling off all or part of the state's interest.

We recognize there are honest differences of opinion regarding the role of the state in some sectors of the economy -- such as utilities and telephone service. But we cannot allow these unique sectors to obscure the fact that in most industries, government ownership is disruptive, inefficient, and is not required. In our opinion, the MDBs must confront these cases head-on.

Country Strategy

All of the MDBs produce lending plans for borrowing countries that set out to varying degrees the resource base and the policies -- taxing, pricing, regulations, investment climate, etc. -- which will best exploit market opportunities in those countries. Too often, however, there is an insufficient connection between country strategy documents and lending. We believe country strategies must serve as a broad guideline in the preparation of individual loans, and should not be undermined. Better coordination on country strategies between the MDBs, bilateral donors and borrowers is needed. In particular, country strategies must be worked out thoroughly with the developing countries to have their full support -- without their support this will not work.

Lending Terms

Finally, we are suggesting moderate changes in concessional lending terms. This includes a reduction of maturities and grace periods, repricing during a loan to reflect changes in a borrower's economic circumstances, and establishment of a small interest charge. Other donor countries have been generally supportive of our desires to reduce maturities and grace periods, and to provide for repricing of future loan contracts.

However, they are strongly resisting our request to charge modest interest rates. We will continue our discussion on these issues with other donors during the course of the ongoing replenishment negotiations.

The Multilateral Investment Guarantee Agency (MIGA)

Consistent with these efforts to strengthen economic policy, the Administration has supported the creation of the Multilateral Investment Guarantee Agency (MIGA), and is requesting Congressional support and approval of the MIGA. The MIGA will promote reform of developing countries investment policies, enhance the private sector's contribution to the development process, and encourage the flow of non-debt capital to developing countries. Its strong mandate to promote policy reform in developing member countries will be a valuable addition to the programs we are using to promote policy reform through the multilateral development banks. In addition, by stimulating the flow of private direct investment to developing countries, the MIGA can be an important component in our international debt strategy by furthering our objective to enhance the role of the private sector in developing countries and the movement toward equity vs. debt capital in these countries.

U.S. membership in the MIGA will also advance our national interests. The United States, as the largest international investor, has a major stake in seeing that appropriate standards for investment protection are developed. Due to its multilateral nature, the MIGA will be better positioned to promote reforms than OPIC or other national insurance agencies, which focus on individual transactions to increase the competitiveness of their investors. This will be a small, cost effective operation requiring little funding. In return we will secure an important new instrument for promoting an improved international economy.

Thus, the Administration believes that the United States should move expeditiously to join the MIGA and seeks authorization and full funding of U.S. membership in the FY 1987 Budget. The $222.0 million U.S. subscription -- which is 20.5 percent of the total -- will include $44.4 million of budget authority of which $22.2 million is to be paid in cash and $22.2 million is to be in the form of non-negotiable non-interest bearing promissory notes. The remainder of the Administration's request is for $177.6 million of callable capital under program limitations. I want to emphasize that this is a one year appropriation; we do not envisage additional budget requests.

The MIGA will be a valuable addition to the multilateral institutions because it is uniquely positioned to further our policies toward development in developing countries as well as serve our own economic interests. Support for its creation comes not only

from the Administration; it has also attracted broad endorsement from the private sector. I therefore urge that the Congress enable us to move expeditiously to become a founding member of the MIGA.

Environment

Mr. Chairman, another critical area of interest regarding MDB policies and operations is the environment. You have expressed concern about the negative impact of some MDB projects on the environment. The Treasury Department has found that MDB performance in this area is mixed, and has expressed its concern in meetings with senior management at the MDBs, and with other member countries. Major problems have surfaced in such projects as dams, penetration roads into relatively undeveloped areas, and agriculture and rural development. Too often, if environmental considerations threaten expeditious project financing, the environment is assigned low priority and is left to be dealt with later. We believe projects in environmentally sensitive sectors should only be accepted if environmental aspects have been thought through, and if measures necessary for sustainable development have been identified and any necessary funding assured. We are carrying out the requirements which you placed in the FY 1986 appropriation act and will be responding to you in detail in the near future.

Cost Effectiveness of the MDBs

It is important to emphasize that while we are seeking changes in the MDBs, they are very important to the conduct of U.S. foreign and economic policy; and they are performing better. Hence, it is in our own self-interest to assure they are adequately funded.

The cost to the United States of trying to duplicate bilaterally what has been achieved multilaterally in the MDBs would be prohibitive. Through 1984 the MDB hard loan windows have made total loan commitments of $133.1 billion at a cost to the United States of only $2.4 billion. The soft, concessional loan windows have made $50.6 billion in loan commitments at a cost to U.S. taxpayers of $14.8 billion. As we have pointed out previously, most of the countries that receive allocations from the State Department's Economic Support Fund (ESF) also receive MDB support. Three countries that receive ESF but no MDB assistance -- Israel, Italy, and Spain -- have per capita incomes too high to qualify as MDB borrowers. Interestingly, there are a number of countries of strategic importance to the United States -- e.g., Argentina, Brazil, and Mexico -- that receive substantial MDB support, but no ESF at all.

It is true that MDB programs do not always live up to the high standards we and the MDBs themselves have set. That is why we are trying to exercise our leadership in directing how the

MDBs can improve their operations. Through our leadership we have been seeing a better product. However, we can only maintain our leadership position if we are willing to bear what the other members mutually perceive to be our fair share in supporting these institutions. We cannot have it both ways, i.e., we cannot for long place more of the burden of fostering and enlarging the international economic system on the MDBs and other international organizations, and then refuse to support them adequately.

Currently we are negotiating replenishments with all of the MDB groups. We have been consulting with the Congress regularly during these negotiations to ensure we are taking into account your views. We will continue these consultations as the negotiations proceed.

These replenishments and aspects of the U.S. debt initiative indicate a potential need for increased resources for the MDBs which is at variance with our current budget environment. The Administration's fiscal year 1986 request for the MDBs was reduced by $228.8 million by Congress in the Continuing Resolution; implementing Gramm-Rudman-Hollings reduced it another $48.1 million. The funding requests reflect a commitment on the part of the United States Government. We have an obligation to our friends and allies to honor these commitments. We will be seeking your support for appropriating these shortfalls.

We are currently discussing with the Department of State and OMB how best to handle these shortfalls in MDB funding. I would urge your support in this effort and ask that you not compound the problem with additional reductions in the FY 1987 budget request for the MDBs.

The Fiscal Year 1987 Budget Request

Our MDB fiscal year 1987 request is composed almost exclusively of funding requirements negotiated by this Administration in close consultation with this Committee.

These funding proposals reflect both the need for budgetary restraint and the financial requirements for effective development programs. The fiscal year 1987 request is for $1.4 billion in budget authority and $3.8 billion under program limitations for callable capital.

International Bank for Reconstruction and Development (IBRD)

For the IBRD in fiscal year 1987, the Administration is requesting: 1) $109.7 million in budget authority and $1,353.0 million under program limitations for subscriptions to the sixth installment of the 1981 GCI; 2) $65.7 million in budget

authority and $685.5 million under program limitations for subscriptions to the first of two installments to the IBRD's 1984 Selective Capital Increase (SCI); and 3) $7.4 million for paid-in capital subscriptions and $66.7 million in program limitations for callable capital subscriptions to the 1970 SCI.

The 1984 SCI totals $8.4 billion and was unanimously approved by the IBRD Executive Board in May 1984. This SCI adjusts members' relative shares to reflect their relative position in the world economy. U.S. participation is the parameter of U.S. support for the World Bank and our willingness to work cooperatively with other donor countries to strengthen the World Bank's financial position and ensure improved cost-sharing.

The Administration continues to believe that the IBRD should play a prominent role in the longer-term development programs of its borrowers and regards "equitable cost-sharing" among donors to be a key element of our participation in all of the MDBs. An important consideration for the United States in negotiating the SCI was the general understanding to maintain a conservative interpretation of the IBRD's "sustainable level of lending" (SLL).

International Development Association (IDA)

For fiscal year 1987, the Administration is requesting $750 million for the third installment for the $2.25 billion U.S. share of the $9 billion Seventh Replenishment. We are pleased at the speed with which the World Bank has moved, with full support of the Executive Board, to strengthen the administration and management of its African operations, with the object of supporting policy reform efforts in this region. We continue to believe the countries of Sub-Saharan Africa and other least developed countries should have first claim on available IDA resources as long as these countries are able to make effective use of these resources.

International Finance Corporation (IFC)

For fiscal year 1987, the Administration is seeking $35.0 million for the second of five installments on the U.S. subscription to a $650 million IFC capital increase unanimously approved by the IFC Executive Board in June 1984.

This capital increase is needed to support an IFC five-year plan for the period FY 1985-1989 that is consistent with the direction and emphasis the United States has encouraged the IFC to take.

Multilateral Investment Guarantee Agency (MIGA)

As mentioned above, for fiscal year 1987, the Administration is requesting $44.4 million in budget authority and $177.6 million under program limitations for the U.S. subscription. Of the budget authority, half ($22.2 million) will be paid in cash and half will be in the form of non-negotiable, non-interest bearing promissory notes that will be treated like callable capital.

The MIGA is a new international institution designed to encourage the flow of investment to and among developing countries by issuing guarantees against political risk, carrying out a wide range of promotional activities and encouraging sound investment policies in member countries. Foreign direct investment, which the MIGA will accelerate, can be a direct substitute for official financial flows. The Administration has strongly supported the creation of this institution and believes that the United States should move expeditiously to join it.

Inter-American Development Bank (IDB)

For fiscal year 1987, the Administration is requesting $58.0 million in budget authority and $1,231.0 million under program limitations for the fourth installment. The lending program based on the 1983 capital increase is designed to continue strong support for the long term development of the countries in Latin America and the Caribbean.

Fund for Special Operations (FSO)

For fiscal year 1987, the Administration is requesting $72.5 million for the fourth installment. The FSO replenishment is designed to address the long term development needs of the poorest countries, primarily in Central America and the Caribbean.

Inter-American Investment Corporation (IIC)

For fiscal year 1987, the Administration is seeking $13 million for the third of four installments to the IIC. The Administration strongly supported establishing the IIC as a practical means of enhancing the capacity of the IDB to aid the private sector in borrowing countries. The investment program will provide loans and equity participation for small- to medium-sized privately controlled firms in Latin America and the Caribbean.

Asian Development Bank (ADB)

For fiscal year 1987, the Administration is seeking $13.2 million in budget authority and $251.4 million under program limitations for the fourth of five installments for the 1983

General Capital Increase. The ADB is a key institution in one of the most economically dynamic and politically sensitive regions of the world. Active and positive U.S. participation has served U.S. interests.

Asian Development Fund (ADF)

For fiscal year 1987, the Administration is requesting $130 million for the fourth installment to the third replenishment. The ADF has supported well designed and effective development projects in some of the poorest countries in the world. U.S. support benefits the people of such countries as Pakistan and Sri Lanka as well as many of the strategic island countries in the South Pacific.

African Development Bank (AFDB)

For fiscal year 1987, the Administration is requesting $18.0 million in budget authority for subscriptions to paid-in capital and $54.0 million under program limitations for callable capital for the fifth of five installments for the initial U.S. subscription to the AFDB.

The AFDB is visible evidence of U.S. commitment to work with the countries of Africa for the achievement of their long term development objectives.

African Development Fund (AFDF)

For fiscal year 1987, the Administration is seeking $75 million in budget authority for the second of three installments for the U.S. contribution to the fourth replenishment. During the period of the fourth replenishment, 85 percent of AFDF lending will go to the poorest African countries. Fund lending will continue to be focused on agriculture with 40 percent of the replenishment resources going to this sector. The remainder of AFDF lending will go to high priority projects for transportation, health, education and water supply.

The substantial increase in the U.S. contribution to the AFDF is a reflection of the Administration's belief that concessional development assistance should be focused on the poorest countries, particularly those of Sub-Saharan Africa.

Fair Export Financing

In addition to our MDB requests, Mr. Chairman, we are seeking funding for the Fair Export Financing Act, which is the President's proposal for a $300 million "war chest" to combat the trade distorting use of tied aid credits.

Tied aid and partially untied aid credits offered by the governments of other countries are a predatory means of financing exports. The market-disrupting effects of these practices have caused the United States to lose export sales. These practices also impede the growth of developing countries to the extent that they divert funds away from legitimate development assistance.

The Administration has proposed an agreement in the Organization for Economic Cooperation and Development that would require at least 50 percent of any such credit to be in the form of a grant. That minimum grant element would make these credits so expensive to use that in practice they would be limited to real foreign aid. We have succeeded in raising the minimum grant element from 20 to 25 percent, but have been blocked from imposing greater discipline over tied aid credits.

Nearly all other OECD members agree that the figure should rise. However, a few countries remain which have so far resisted efforts to negotiate an effective end to this predatory concessional financing.

The "war chest" proposal seeks to strengthen the U.S. negotiating position through an appropriation in the amount of $300 million for the creation of a temporary tied aid credit facility in the Department of the Treasury. The facility would be used to provide grants tied to Export-Import Bank and/or private credits targeted at the export markets of those countries which engage in such tied aid and partially untied aid credits and which block progress toward an arrangement to restrict tied aid credits. This facility could support up to $1.0 billion in tied aid credit authorization.

It should be emphasized that this facility would be used selectively to provide leverage to the Secretary of the Treasury in negotiating the elimination of predatory and trade distorting financing by other countries. Under our budgetary constraints, we cannot hope to provide enough assistance to all of our exporters to allow them to match effectively the tied aid offers of foreign competitors worldwide. We have drafted our proposal selectively, in a cost-effective fashion, so that we can specifically target those users of tied aid credits delaying a negotiated solution. Only a negotiated end to the practice will provide the kind of relief and a level playing field that all of our exporters deserve.

Authorizing legislation has been introduced in both Houses of Congress, and hearings have been held. We hope that a

final product will be approved very soon. I hope that this Committee will also give prompt and positive attention to the request.

Conclusion

In conclusion, Mr. Chairman, I want to emphasize the Administration's commitment and full support for the MDBs. They play an important role in U.S. foreign and international economic policy. Now, we are asking them to take a more active part in supporting growth-oriented policy reform in the developing countries -- to play a central role in implementing the "Program for Sustained Growth". Successful implementation of this program will be very helpful to the U.S. economy; it will increase effective demand among developing countries for U.S. exports, and will reduce the strains on the international financial system by helping developing countries reduce their debt service obligations to more manageable proportions.

I recognize fully that even in the best of circumstances supporting foreign assistance is never popular. Now, at a time of severe budget constraint, it will be even more difficult. But I strongly believe that if we do not firmly support the MDBs now, we may have to resort to more costly measures later.

TREASURY NEWS

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FOR IMMEDIATE RELEASE
March 13, 1986

CONTACT: Art Siddon
566-2041

MAR 18 10 09 AM '86
DEPARTMENT OF THE TREASURY

TREASURY ANNOUNCES PROPOSED REGULATIONS FOR BOOK-ENTRY SECURITIES

The Department of the Treasury today released proposed regulations that would revise its existing rules for transferring interests in Treasury marketable book-entry securities. These rules will apply to Treasury securities held in the commercial book-entry system, which is now designated as the Treasury/Reserve Automated Debt Entry System ("TRADES"). The revision of the existing regulations is intended to provide investors in Treasury securities held in book-entry (non-paper) form with more straightforward procedures by which their interests in those securities can be established and maintained.

Public comment on the proposed regulations can be submitted during a 60-day period from the date of publication in the Federal Register. Treasury encourages all sectors of the government securities market to give the proposed rules careful consideration.

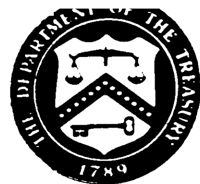
The proposed rules respond to the desire of investors, dealers, clearing banks and other participants in the government securities market for clear and commercially practicable rules for transferring interests in book-entry Treasury securities. The proposed regulations would accomplish this result by creating uniform Federal rules concerning the transfer of Treasury book-entry securities. These rules are based on best current commercial practice and on existing law governing uncertificated securities under Article 8 of the Uniform Commercial Code.

Once they are finally adopted, the regulations will apply to both existing and new securities, although they will not limit contractual obligations of the United States with respect to any security issued and outstanding prior to the effective date described in the regulations. Also, the rights of private parties in securities transactions that occur before the effective date will not be altered by the new regulations.

The revision of Treasury's existing book-entry regulations is part of an overall Department effort to issue its marketable securities exclusively in book-entry form. In mid-1986, the Treasury will initiate a new Treasury Direct Access Book Entry System ("TREASURY DIRECT") intended for use primarily for investors who usually hold securities to maturity. Once conversion to the new system is completed, all Treasury book-entry securities will be held either through the TRADES system or in TREASURY DIRECT (formerly referred to as T-DAB). The regulations governing TRADES, together with companion regulations governing TREASURY DIRECT (published in proposed form in December 1985), will form a comprehensive set of rules governing all marketable Treasury book-entry securities. Copies of the proposed TRADES regulations are available from the Department of the Treasury and the Federal Reserve Banks.

B-498

TREASURY NEWS



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FOR RELEASE AT 4:00 P.M. March 12, 1986

MAR 18 10 09 AM '86
DEPARTMENT OF THE TREASURY

TREASURY TO AUCTION $9,500 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $9,500 million of 2-year notes to be issued March 31, 1986. This issue will provide about $1,150 million new cash, as the maturing 2-year notes held by the public amount to $8,348 million, including $598 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

In addition to the maturing 2-year notes, there are $3,746 million of maturing 4-year notes held by the public. The disposition of this latter amount will be announced next week. Federal Reserve Banks as agents for foreign and international monetary authorities currently hold $1,035 million, and Government accounts and Federal Reserve Banks for their own accounts hold $1,458 million of maturing 2-year and 4-year notes.

The $9,500 million is being offered to the public, and any amounts tendered by Federal Reserve Banks for their own accounts, or as agents for foreign and international monetary authorities, will be added to that amount. Tenders for such accounts will be accepted at the average price of accepted competitive tenders.

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

oOo

Attachment

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC OF 2-YEAR NOTES TO BE ISSUED MARCH 31, 1986

March 12, 1986

Amount Offered:

To the public	$9,500 million

Description of Security:

Term and type of security	2-year notes
Series and CUSIP designation	X-1988 (CUSIP No. 912827 TK 8)
Maturity Date	March 31, 1988
Call date	No provision
Interest 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	September 30 and March 31
Minimum denomination available ..	$5,000

Terms of Sale:

Method of sale	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None
Payment by non-institutional investors	Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts ...	Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions	Acceptable

Key Dates:

Receipt of tenders	Wednesday, March 19, 1986, prior to 1:00 p.m., EST
Settlement (final payment due from institutions)	
a) cash or Federal funds	Monday, March 31, 1986
b) readily-collectible check ..	Thursday, March 27, 1986

TREASURY NEWS

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE

March 13, 1986

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,014 million of 52-week bills to be issued March 20, 1986, and to mature March 19, 1987, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	6.59%	7.03%	93.337
High -	6.63%	7.08%	93.296
Average -	6.61%	7.06%	93.317

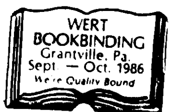
Tenders at the high discount rate were allotted 59%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 19,150	$ 19,150
New York	19,264,070	7,522,120
Philadelphia	7,200	7,200
Cleveland	15,960	15,960
Richmond	60,960	60,960
Atlanta	32,970	28,870
Chicago	1,550,485	377,835
St. Louis	79,110	53,110
Minneapolis	13,865	13,865
Kansas City	44,720	44,720
Dallas	6,705	6,705
San Francisco	1,278,270	737,850
Treasury	125,595	125,595
TOTALS	$22,499,060	$9,013,940
Type		
Competitive	$19,500,275	$6,015,155
Noncompetitive	548,785	548,785
Subtotal, Public	$20,049,060	$6,563,940
Federal Reserve	2,250,000	2,250,000
Foreign Official Institutions	200,000	200,000
TOTALS	$22,499,060	$9,013,940

An additional $200,000 thousand of the bills will be issued to foreign official institutions for new cash.

B-500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