U.S. Dept. of the Treasury

PRESS RELEASES

TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
AT 1:30 P.M.

REMARKS FOR
SECRETARY OF TREASURY
JAMES A. BAKER, III
BEFORE THE
GREATER NEW YORK CITY U.S. SAVINGS BONDS CAMPAIGN
FRIDAY, MARCH 14, 1986

I am pleased and honored to be with some very distinguished members of the New York business community.

America has been celebrated for many things since she was born free in a world full of monarchies not so long ago. Perhaps none is so inspiring as the willingness of her citizens to use their freedom to join together and build a better society.

You have stepped forward for America. You have lent your prodigious talents and enthusiasm to the cause of United States Savings Bonds.

You are here because Savings Bonds are important to the debt management program of the U.S. government.

For every one billion dollars worth of Bonds sold, about $54 million in interest costs is saved the government and taxpayers. In a diversifying financial marketplace, Savings Bonds have a secure niche as a no-risk, low-cost, easy to buy savings instrument with an excellent return.

In fact, Savings Bonds sales last month were up 32 percent from a year earlier. A front page story in USA TODAY was headlined "HOT BUY -- 8 percent plus -- Savings Bond Boom." This is a promising start for 1986 and with everyone's help I believe it will be another outstanding year for Savings Bonds.

Effect of the High Dollar

Now, I'd like to broaden the perspective a bit and take a look at an area that is familiar to you -- the international economy. As key players in the world's leading financial center, you are acutely aware of exchange rates. You know how billions of dollars flash instantly across borders and oceans, and how profits can be made and lost over seemingly infinitesimal changes in the values of currencies. The sun never sets on exchange markets. As they say, "the heat is always on."

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The powerful influence of exchange rates is illustrated by the sharp rise of the dollar earlier in this decade. From the middle of 1980 to its peak in February of last year, the dollar rose 42 percent on average against other major currencies. Against some of these the dollar more than doubled.

This has created problems for our exporters and those who compete against imports. Some economists estimate that the strengthened dollar caused a third to a half of our trade deficit last year. I know that one of your fellow companies calculated that the high dollar may have reduced its earnings by $1 billion or more over a four year period.

Not surprisingly, the dollar's increase reinforced some of the fiercest protectionist pressures we've seen since the days of the Smoot-Hawley tariff. We've all seen countless news stories on this subject. At Treasury we tried to calculate approximately how many. The result demonstrated the increasingly close relationship between exchange rates and trade policy.

We conducted a computerized word search (Nexis) of major publications such as The New York Times and The Washington Post. We counted the number of news stories in which the words "protectionist" or "protectionism" appeared within 25 words of the word "dollar". In 1980, as the dollar was just beginning its steady ascent, such a linkage occurred only ten times.

The next year it happened in 12 stories. Then 55 in 1982, rising to 91 in 1983. There were 124 by 1984 -- over 12 times as many in 1980. And in 1985, when the dollar hit its peak, "protectionism/protectionist" and "dollar" were within 25 words of each other in 402 stories. In all, the rise in the number of stories coincided remarkably with the rise of the dollar.

Fundamentals Behind Currency Values

In addition to the media, the strong dollar focused the attention of politicians and economists on the operation of the international monetary system. Debate has arisen over whether there are ways to improve exchange rate stability and avoid wild currency swings. But before entering this dialogue, we must remember that exchange rates are like seismographs. They measure underlying trends and tremors.

Few people would disagree that the stability of the international monetary system is directly related to the harmony of economic fundamentals among the major industrialized countries. By fundamentals, I mean measures of economic performance such as growth, inflation, and unemployment. Exchange market instability occurs when there are dissonant economic fundamentals among countries.

That was why our dollar strengthened so vigorously earlier in this decade. In late 1982, we came out of recession sooner and stronger than most of the rest of the world. As growth lagged in other industrial countries, and some LDC's experienced serious financing problems, investors sought haven in a less tumultuous and more prosperous United States.

International Monetary Policy

The way for major industrialized countries to promote stability in exchange markets is through a favorable convergence of economic performance and consistent policies.

The meeting of the G-5 nations here at the Plaza Hotel last September was a major step in that direction. The G-5 representatives announced their intentions to reduce structural impediments to growth, control government expenditures, avoid protectionism, and improve investment climates.

They also concluded that exchange rates did not fully reflect the basic improvement in growth and inflation performance in other countries. In light of this fact, the G-5 members agreed, for the very first time, that some further orderly appreciation of the main non-dollar currencies against the dollar was desirable.

The effect of this announcement on the exchange market underscored the market's recognition of the favorable convergence of G-5 economic policies and performance. Since September 22, the dollar has fallen, in generally orderly conditions, by 21 percent against the Deutschemark, and 26 percent against the yen.

With that drop in the dollar the Treasury tells me that I might have to change my signature on the dollar bill from James A. Baker the third to James A. Baker the "two and a half."

The dollar's decline is obviously good news for exporters, and for all who are concerned about the trade deficit and protectionism. I have heard from quite a few businessmen who are now optimistic about the export picture. Given the dollar drop, lower oil prices, and increased demand overseas, we believe the trade deficit will start to shrink by the end of this year.

The dollar's drop will not produce an immediate cut in the trade deficit. Past experience suggests that the full effect of favorable changes in exchange rates on the trade balance takes 12 to 18 months. Consumer buying habits don't change right away, and long-term contracts must expire.

But eventually Adam Smith wins out. Price changes have an effect. Imports slow and exports pick up. The trade deficit will finally come down. At the same time, most analysts expect inflation to stay low, especially as the price of oil declines.

Building on Progress

What can we do to build on the progress we've made so far?

At home, we must continue our efforts to cut government spending and pass a tax reform bill with sufficient incentives for productivity and growth.

From our fellow industrial countries we need policies that promote strong noninflationary growth. This will boost demand for our exports, reduce current account imbalances, and strengthen the Administration's hand against protectionist legislation. Such policies will also provide expanding markets for LDC countries as U.S. import growth slows.

To sustain any expansion, it is critical that the other industrialized countries press ahead with structural reforms. We believe the Japanese should take further steps to liberalize capital markets, develop mortgage and consumer debt markets and enact tax reform that addresses their savings-consumption imbalance. The Germans could improve growth prospects for their economy by deregulating certain labor and capital markets and reforming their tax code as well.

It is also vital that industrialized countries allow the recent decline in oil prices to be fully passed on to consumers, boosting real income and hence domestic demand, in their economies.

Although no one can predict exactly how oil prices will move, average dollar prices in 1986 will be well below the 1985 level. This makes possible a considerable reduction in inflation rates.

If prices remain low, we could see another sizable drop in the inflation rate for the industrialized countries this year. Forecasting the effect of falling prices on economic growth is also tricky, but on average real GDP growth could accelerate as well.

These benefits from falling oil prices led the central banks of Germany, Japan, and the United States to lower discount rates last week. That action is a welcome step toward achieving strong noninflationary growth.

I believe that the goal of international growth is all the more possible because of the spirit of cooperation among the major industrialized nations. The harmony of the G-5 allows us to take advantage of favorable economic circumstances.

Now this brings me back to the challenge of advancing our efforts to improve the international monetary system. This month marks the 13th anniversary that world economy has been operating on a sea of floating exchange rates. Given some of the rough passages over that period of time, we think it's worth considering whether some changes might be made to promote more stability in the international monetary system.

The President has asked me to determine if the nations of the world should meet to discuss the role and relationships of our currencies. There is now no fixed timetable for this decision. We will assess the situation after discussions of monetary issues at the April IMF Interim Committee meeting before reaching any decisions on how to proceed.

Less Developed Country Growth

The twin goals of monetary stability and favorable economic performance are not limited to the major industrialized countries.

Without stronger growth by less developed countries, there can be no solution to their debt problems. Debtor countries simply must accumulate resources -- and export earnings -- faster than they accumulate debt.

Improved growth and lower interest rates in the major industrialized countries will provide substantial economic benefits for developing countries. Additional efforts, however, are also needed.

Our debt initiative, the "Program for Sustained Growth," involves three critical groups of players -- the debtor countries, the international financial institutions, and commercial banks.

The initiative emphasizes the importance of structural reforms that are needed to lay a firm foundation for stronger growth among the debtor nations. These include privatization of public enterprises, more efficient domestic capital and equity markets, growth-oriented tax reform, a more favorable investment climate, and trade liberalization.

Such reform is difficult and won't happen overnight. Financing will be needed to induce countries to make these difficult choices.

The International Monetary Fund must continue to play its very important role in the overall debt strategy. The Fund's main mission involves relatively short-term balance of payment programs. The need to focus IMF resources on these programs will mean that its efforts must be complemented by World Bank measures to encourage longer-term adjustment.

The World Bank is well placed to play an expanded role in promoting structural reforms by LDC's. Most of the new lending from the World Bank will be fast-disbursing sectoral and adjustment loans. We believe it can boost annual lending by some $2 billion for each of the next three years and concentrate those loans more heavily on large debtors with credible reform programs.

If the debtor nations make the needed reforms, the commercial banks should pitch in and do their share to help these debtor countries and the international financial institutions move the process along. Banks in nearly all of the major creditor nations have voiced support for our debt initiative. We call on them to increase their exposure by a modest 2.5 to 3 percent annually, $20 billion in net new lending over the next three years.

But we will not support across-the-board government or World Bank guarantees to induce commercial bank lending. If sound growth-oriented policies are adopted by the debtor countries, the banks will benefit from improvements in the quality of outstanding loans.

Let me repeat -- the banks will make these loans if it's in their self-interest to do so. We are not going to twist any arms and we are not going to bail out any bad loans.

Contrary to what you may have read in the press, the debt initiative has already begun. Virtually all of the debtor countries are participating in negotiations with the World Bank, some more fully and successfully than others.

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

Other nations already have certain elements of the strategy in place and will focus primarily on unlocking additional World Bank resources. 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.

The recent decline in interest rates and oil prices will improve prospects for most debtor nations. Oil importing debtors will benefit in several ways -- through reduced oil bills, new and larger export markets in a more rapidly growing industrialized world and lower interest payments on debt as lending rates follow inflation down.

The recent decline in interest rates should help save debtor countries $7 to $8 billion on their commercial bank debt this year alone.

The major oil producing debtors, Mexico, Venezuela and Nigeria should find the decline in their export earnings partially offset by the higher growth and reduced interest rates in industrial countries. But even if the price of oil were to average $15 per barrel this year, the financing needs of the 15 major debtors would remain manageable within the framework of our initiative without extraordinary financing measures.

Obviously some extremely complex problems must be resolved as the initiative proceeds. 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 needs to be carefully worked out.

Conclusion

When we look at the complexities of international monetary reform and LDC debt, we may conclude that our tasks are great, but they are quite within our capacity. The outlook for U.S. growth, inflation and employment has improved substantially with the decrease in the price of both the dollar and oil.

Not least, the outlook is brighter because of an increase in international cooperation. The volunteer spirit brought us here today, and I think it's brought nations together recently to work on common economic problems.

We now have an opportunity to build on this positive spirit and work toward lasting progress for all nations. Adlai Stevenson once said, "the world at our mid-century is like a drum -- strike it anywhere and it resounds everywhere." Those words are all the more true today.

Thank you very much.

TREASURY NEWS
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FOR IMMEDIATE RELEASE

March 17, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 6,814 million of 13-week bills and for $ 6,807 million of 26-week bills, both to be issued on March 20, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 19, 1986			:	26-week bills maturing September 18, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	6.49% a/	6.69%	98.359	:	6.52%	6.84%	96.704
High	6.53%	6.73%	98.349	:	6.56%	6.88%	96.684
Average	6.52%	6.72%	98.352	:	6.55%	6.87%	96.689

a/ Excepting 1 tender of $645,000.

Tenders at the high discount rate for the 13-week bills were allotted 66%.
Tenders at the high discount rate for the 26-week bills were allotted 79%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 41,175	$ 41,175	:	$ 16,855	$ 16,855
New York	19,803,885	5,767,245	:	19,815,950	5,858,150
Philadelphia	27,205	27,205	:	20,525	20,525
Cleveland	47,325	47,325	:	24,090	24,090
Richmond	46,155	46,155	:	49,985	49,985
Atlanta	50,805	47,405	:	52,410	41,360
Chicago	1,583,815	253,415	:	1,548,060	151,820
St. Louis	73,715	45,715	:	68,970	48,970
Minneapolis	12,875	12,875	:	9,605	9,605
Kansas City	43,795	43,795	:	38,325	38,275
Dallas	39,210	32,510	:	26,980	20,930
San Francisco	1,530,260	142,220	:	1,251,980	175,010
Treasury	307,240	307,240	:	351,010	351,010
TOTALS	$23,607,460	$6,814,280	:	$23,274,745	$6,806,585
Type					
Competitive	$20,211,675	$3,418,495	:	$19,892,585	$3,424,425
Noncompetitive	1,048,730	1,048,730	:	860,460	860,460
Subtotal, Public	$21,260,405	$4,467,225	:	$20,753,045	$4,284,885
Federal Reserve	1,750,655	1,750,655	:	1,750,000	1,750,000
Foreign Official Institutions	596,400	596,400	:	771,700	771,700
TOTALS	$23,607,460	$6,814,280	:	$23,274,745	$6,806,585

1/ Equivalent coupon-issue yield.

REASURY NEWS
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FOR RELEASE UPON DELIVERY
AT 9:00 A.M.

REMARKS BY
SECRETARY OF THE TREASURY
JAMES A. BAKER, III
AT THE FIFTEENTH ANNUAL FINANCIAL MANAGEMENT CONFERENCE
WASHINGTON, D.C.
TUESDAY, MARCH 18, 1986

Thank you for that generous introduction, Jerry. It is an absolute pleasure to be with all of you this morning.

And before I begin, I'd like to salute each one of you, not just on my own behalf, but also on behalf of President Reagan. Despite the many demands on his time, he is well aware of your contributions to efficiency and integrity in government.

I'd like to turn to some issues facing Federal Financial Managers. In recent years you have been asked to take on new responsibilities. You have moved from your traditional roles as the government's accountants and budgeteers into the realm of financial asset management, first with cash management and more recently with credit management and debt collection.

I'm proud that Treasury's Financial Management Service has played a leadership role in this effort. Treasury's ability to manage the government's cash and debt has been enhanced considerably by the development of better collection and payment systems, plus agency efforts to manage cash, credit, and other working capital assets.

But the progress we've made is largely due to the tireless dedication of agency managers who get these things done. Your accomplishments are remarkable considering constraints on staffing and funding. We need you now more than ever!

The President's Reform '88 initiatives will further our objectives in financial resource and information management. The Office of Management and Budget and the Treasury Department are both involved in achieving those objectives and we have complementary strengths. Under the so-called "lead agency" program, we have forged a successful new partnership.

That program has two broad objectives -- effective management of agency program resources and improved reporting to meet management, oversight and public needs.

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Most of you deal with one or more of these initiatives every day, and I'd like to mention them, at least in passing.

In Cash Management, for example, you have generated real interest savings of over $1 billion. Debt Collection is an area where OMB has put much emphasis in the past several years. Credit Management -- we will work closely with lending agencies to meet the objectives of OMB's circular A-129.

We are confident that the skill and imagination of financial managers will enable us to upgrade Financial Systems at a price the country can afford.

Government-wide financial reporting is also a priority. Better data can reduce the number of surprises and provide time to deal with financial problems before they reach crisis proportions.

Loan Sales are another new venture that we will pursue in creative ways. Electronic Funds Transfer is the wave of the future -- the day is not too far off when most of our payments will be made electronically.

You have many challenges ahead. You will be setting goals and laying out options toward reaching those goals. Some of these options will seem to be deceptively easy. They're the quick-fixes. Others are more difficult and require patience, time and effort. But if followed through, they will ultimately succeed long after the quick-fixes have failed.

The same philosophy applies to international economic policy as well. Progress comes with patience. I'd like to discuss our "management" approach to such difficult issues as trade and less developed country debt.

Some suggest simple protectionist solutions to the trade deficit. But we believe we must take into account fundamental long-term factors. Trade problems are best solved by achieving balanced, strong and noninflationary growth among all nations.

To do this we take a page out of your book. Financial managers well know how colleagues should consult and reach a consensus before making a decision and proceeding on an endeavor. It is a good practice for countries as well.

The meeting of the G-5 nations -- Great Britain, France, West Germany, Japan, and the United States -- in New York City last September was a major step toward improving the coordination of sound economic policies. The G-5 representatives announced their intentions to reduce structural impediments to growth, control government expenditures, avoid protectionist trade measures, and improve investment climates.

They also concluded that exchange rates do not fully reflect the basic improvement in growth and inflation performance in other countries. As you know, the U.S. dollar appreciated significantly from 1980 until February of last year. This caused problems for exporters and for those who compete against imports. It worsened dangerous protectionist pressures.

The G-5 members agreed, for the first time publicly, that some further orderly appreciation of the main nondollar currencies was desirable. The effect of this announcement on the exchange market was dramatic. Since September 22, the dollar has fallen, in generally orderly conditions, by 21 percent against the Deutschemark, and 28 percent against the yen.

With that drop in the dollar the Treasury tells me I might have to change my signature on the dollar bill from James A. Baker III to James A. Baker the "two and a half."

The dollar's decline is obviously good news for exporters and for everyone concerned about the trade deficit.

Beyond exchange rates, we must continue to harmonize fundamental economic factors in the spirit of the G-5. The recent action by the United States, West Germany and Japan to lower discount rates was welcome sign of cooperation.

We in the America must also do our part by cutting government spending and passing a tax reform bill that promotes productivity and economic expansion.

From our fellow industrial countries we need growth-oriented policies as well. Their growth is beginning to accelerate, and must be sustained. More vigorous foreign economies will demand more of our exports, reduce current account imbalances, and strengthen this Administration's hand against protectionist legislation. Such growth will also provide expanding markets for LDC countries as U.S. import growth slows.

It is also vital that industrialized countries allow the recent decline in oil prices to be fully passed on to consumers. If governments don't tax away this new wealth, it will boost real income and stimulate growth in their economies.

In all, given these three factors -- the drop in the dollar, declining oil prices, and increased growth abroad, we conclude that the trade deficit will shrink by the end of this year. The full effect of the dollar decline will not be felt immediately. It takes some time for consumer buying habits to change, and for long-term contracts to expire.

But eventually, the trade deficit will come down. We look forward to that moment. Keeping that in mind makes it easier for all to avoid the temptations of protectionism.

Our goal of economic growth is not limited to the major industrialized countries. Without stronger growth by less developed countries, there can be no solution to their debt problems. All industrial nations would be poorer for that. Debtor countries simply must accumulate resources -- and export earnings -- faster than they accumulate debt.

Our debt initiative, the "Program for Sustained Growth," has three elements that depend on each other -- growth-oriented economic reforms by debtor countries, net new lending by international financial institutions, and net new lending by commercial banks. Simply, if the debtors make needed reforms, they should get more financing to help the process along.

Contrary to what you may have read in the press, the debt initiative has already begun. All three groups have responded favorably to our proposal. Virtually all of the debtor countries are participating in negotiations with the World Bank, some more fully and successfully than others.

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

Other nations already have certain elements of the strategy in place and will focus primarily on unlocking additional World Bank resources. 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.

So, as with the trade deficit, we are moving toward our goal. We must not let our heads be turned by quick-fix ideas like writing down the LDC debt. That would only cause a serious 'hit' to our banks, damage to our exporters, and the loss of some democratic countries in Latin America. Nor do we favor other so-called easy solutions such as across-the-board government or World Bank guarantees to induce commercial bank lending.

Let me repeat -- the banks will make these loans if it's in their self-interest to do so. We are not going to twist any arms and we are not going to bail out any bad loans. This would be poor management of a manageable problem.

You well know the results of bad management. You probably recall better than most how the rapid growth of government programs in recent decades overwhelmed the management structure needed to administer these programs.

In many cases we basically did not plan ahead. The result was often ad hoc management and short-sighted policy making. This Administration recognizes those deficiencies and with your help, we're correcting them.

Likewise we firmly oppose shortsighted trade policies. Many in the Congress are planting protectionist time bombs on the legislative calendar. They are scheduled to explode just before the November elections.

And just as the trade deficit should start to ease!

Let's not ruin this brighter future by indulging in tariffs and quotas or by putting our trade laws on automatic pilot. Let's not overlook the benefits of the lower dollar, cheaper oil and more growth overseas. Let's keep in mind what should happen to the trade deficit this year rather than what occurred last year.

By the same token, we have designed a well-received framework for managing the LDC debt problem. Let's follow through with it, not by altering our plans or submitting new blueprints, but by building on the foundation that has already been laid.

Progress in public policy cannot be measured by an hourglass. Progress is measured by results. We do not race against the clock. We race against ourselves. We strive to do better than before.

A few minutes ago I congratulated you on your success, but we all know that in terms of achieving excellence, we are still much closer to the beginning than the end. So, our challenge remains the same. Don't look back, nor at the crowd, but to the finish.

Thank you very much and good luck.

TREASURY NEWS

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FOR IMMEDIATE RELEASE
March 18, 1986

CONTACT: Art Siddon
566-5252

CURRENCY CHANGES ANNOUNCED

Treasury Secretary James A. Baker, III announced today changes to the United States currency necessary to continue protecting the public in ordinary currency transactions by deterring counterfeiting at the source.

The development of advanced copying machines that permit high resolution color reproduction, even by unskilled operators, is rapidly increasing. The future widespread availability of such copiers threatens to create a new kind of problem involving so-called "casual counterfeiters" with access to such equipment. This "crime of opportunity" involving small amounts of counterfeit notes in widely dispersed locations could seriously hamper the Secret Service's enforcement efforts.

These are the only changes contemplated now. The Treasury Department is not considering changes in currency design or color; nor is the Department proposing any recall, demonetization, or devaluation of the currency.

The changes approved by the Secretary will add:

A security thread -- A clear polyester thread will be incorporated into the paper. It will be arranged vertically through a narrow clear field on the notes and will be able to be seen with the human eye when held to a light source. Each denomination will have an identifiable printed pattern on the thread.

The thread will be located between the left border of the note and the Federal Reserve seal on all notes except the one dollar denomination. On the one dollar note the thread will be located between the Federal Reserve seal and the portrait. The thread is embedded in the paper used for U.S. currency.

The printed thread can only be detected with transmitted light. Copiers use reflected light and are unable to reproduce the pattern shown on the thread.

B-504

Microprinting on the face of the note -- The words "United States of America" will be engraved repeatedly around the portrait on the face of the note. Very few copiers now have the resolution capability to reproduce accurately the microprinting.

All existing anticounterfeiting features in the currency will be maintained. The new features will deter the casual counterfeiter and complicate the task of the professional counterfeiter.

These two additional deterrents together will provide effectiveness for the immediate future. They can be mass produced with no effect on the current life cycle of the notes, with minimal cost to the Government.

The Treasury's Bureau of Engraving and Printing is continuing its research and development of additional counterfeiting deterrents. As that research and development progresses, the applicability of new deterrents to the currency will be evaluated.

Production of the new currency is scheduled to begin in 12 months, with the first notes entering circulation in 15 to 18 months.

Both the new currency and existing currency will be legal tender and will circulate side by side. Old currency will be removed from circulation in the normal course of currency processing at the Federal Reserve Banks and Branches. It will remain legal tender as long as it is in circulation.

An in-depth briefing for the press will be conducted by Treasury officials at the time the currency is introduced.

TREASURY NEWS

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

STATEMENT OF THE HONORABLE DAVID D. QUEEN
ACTING ASSISTANT SECRETARY (ENFORCEMENT & OPERATIONS)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

March 18, 1986

White Collar Crime Oversight Hearing on Money Laundering

Mr. Chairman and members of the Committee:

Thank you for the opportunity to appear before you today on the subject of money laundering. Because the Treasury Department, like the Justice Department, has testified in the past before this Committee in great detail on this subject, I will not go into depth regarding the history of Treasury's battle against money laundering. Instead, I will provide an update on Treasury's involvement with this issue since we last appeared before you. I will then discuss briefly legislative initiatives that will assist in Treasury's enforcement of the Bank Secrecy Act.

At the outset, let me express my appreciation to you, Mr. Chairman, and the members of this Committee for your continuing interest in this topic. This Committee is fully aware of the implications of the money laundering problem -- for law enforcement, for our financial community, and for our society at large. The Treasury Department welcomes the opportunity to work with you as you explore methods of improving our nation's response to this challenge.

The enforcement and administration of the Bank Secrecy Act is the centerpiece of Treasury's efforts to combat money laundering. The reporting data generated pursuant to the Act and the regulations under it are essential to our country's investigations into drug trafficking, organized crime, and a host of related offenses. State and local law enforcement, as well as Federal agencies, make use of this data to initiate investigations and to support ongoing investigations.

Improved Compliance with the Reporting Requirements

Over the last several years, Treasury has devoted substantial attention to improving the compliance of financial institutions with the reporting of cash transactions under the Bank Secrecy Act. This effort has resulted in a major increase in the number of Currency Transaction Reports, or Forms 4789, filed with the Internal Revenue Service. Approximately 700,000 such forms were filed in 1984, and an estimated 1.7 million were filed last year.

The vast increase in reporting volume has temporarily exceeded the capability of the IRS to process the forms and add the information to the data base. However, IRS has directed considerable attention to this problem, and $6 million is included for this in the pending FY 1986 supplemental of $340 million. A new division of approximately 250 people has been established at the Detroit Data Center to process the Currency Transaction Reports (CTRs), and the Reports of Foreign Bank Accounts. It is my understanding that they are now capable of handling the current level of receipts, which is approximately 60,000 CTRs per week. Arrangements have been made to contract out the processing of 700,000 CTRs. We expect that the backlog will be eliminated by June of this year.

The Office of Financial Enforcement

Another improvement in our administration of the Act has been the establishment last year of the Office of Financial Enforcement. We have taken this step to place greater emphasis on the program and provide a basis for expanding Treasury's program to administer the Bank Secrecy Act.

Civil Penalty Assessment-Relation to Criminal Cases

In the wake of the publicity surrounding the Bank of Boston case, over sixty banks or bank holding companies have been identified as being in violation of the Bank Secrecy Act. Many of these institutions have come forward as volunteers. Others have come forward as a result of bank regulatory exams, particularly those of the Comptroller of the Currency. To date, thirteen civil penalties have been assessed under 31 U.S.C. § 5321, ranging from $121,000 to $ 4.75 million in the case of Bank of America. The dollar amounts of the penalties that have been assessed to date reflect the level of cooperation and commitment to future compliance of the banks involved, as well as other factors. Other cases are under review, and we anticipate that additional penalties will be assessed shortly. In many instances, the cases are taking several months to conclude because of the time required for banks to conduct an examination of past compliance and to reconstruct past unreported transactions for late-filing of Currency Transaction Reports.

In all the cases in which penalties have been assessed, Treasury predicated the assessment on a finding of a willful violation based on reckless disregard for the law. In no case have we found instances of intentional money laundering or specific intent to violate the law. If specific intent to violate is evidenced, it would be our policy generally to refer the matter for possible criminal action prior to civil action.

In a case of voluntary disclosure of substantial non-compliance or penalty referral by a bank regulatory agency, we routinely refer the case to the Criminal Investigations Division of the Internal Revenue Service for evaluation and investigation. The Internal Revenue Service then decides whether to refer the matter to the Department of Justice for criminal prosecution. If there is an ongoing criminal prosecution, we discuss with the United States Attorney's Office that is handling the case whether to proceed with the civil case or to defer action until the conclusion of the criminal case.

Criminal penalties (under 31 U.S.C. § 5322) and civil penalties (under 31 U.S.C. § 5321) are cumulative. There is nothing to preclude imposition of civil penalties at the conclusion of a criminal case or imposition of criminal penalties at the conclusion of a civil case. We explicitly state in all our penalty settlement agreements that nothing in the agreement "limits in any way the right of the United States to investigate or prosecute any criminal violation of the Act."

We want to emphasize that Treasury has not as yet closed the door to volunteers, and we continue to encourage financial institutions to come forward with past violations. Non-volunteer banks will be dealt with more severely. Financial institutions that have not filed required Currency Transaction Reports for any reason have a continuing legal duty to do so. The case of a bank that becomes aware of past non-compliance and makes no effort to contact Treasury and to late-file Currency Transactions Reports as we direct, will not be treated as a civil case.

We believe that Treasury's rigorous enforcement of the Bank Secrecy Act, including the imposition of publicly announced, substantial civil penalties, where appropriate, has contributed to enhanced awareness of the requirements of the Bank Secrecy Act. As a consequence, we believe, as confirmed in our dealings with the many banks with which we have met, that overall compliance has improved and that full compliance has become a high priority with many major financial institutions.

Legislative Intiatives

I would now like to discuss briefly legislative measures that will help in the fight against money laundering and enhance Treasury's Bank Secrecy Act enforcement efforts. First and foremost is early and favorable action on the "Money Laundering and Related Crimes Act," S. 1335, which was developed jointly by the Departments of Treasury and Justice. From Treasury's standpoint, this bill contains two critical revisions to the Bank Secrecy Act. First, the bill provides Treasury with civil summons authority for the first time. Second, the bill provides for a civil penalty for negligent violations of the Bank Secrecy Act. Currently, Treasury has authority to assess civil penalties for "willful" violations under 31 U.S.C. § 5321. "Willful" in a civil penalty context means with specific intent or with reckless disregard of the law. Nevertheless, mere negligent non-filing of currency reports deprive the Government of potentially useful law enforcement information to the same extent as willful non-filings. The prospect of penalties for negligent violations should encourage financial institutions to give more attention to good compliance.

There are two other legislative proposals not contained in S. 1335, that were drafted at the request of Subcommittee Chairman Pickle and forwarded to him by Treasury in January. We would like to take this opportunity to share these proposals with the Committee today. We will also share these proposals with the other committees considering the Administration's bill.

The first proposal would prohibit structuring of currency transactions to avoid the $10,000 currency transaction reporting requirement. Structuring includes the well-known practice of "smurfing". Recent decisions in three Federal Circuits have made it clear that the current law is inadequate to sustain consistent prosecutions for structuring. The proposal would make a person who structures transactions to avoid the currency reporting requirements, or who causes a financial institution not to file a required report, subject to the criminal and civil sanctions of the Bank Secrecy Act.

The second proposal would provide seizure and forfeiture authority for currency related to a domestic reporting violation or interest in property traceable to the currency. The forfeiture would not affect bona fide purchasers who took the currency or property without notice of a reporting violation.

Currently, there is forfeiture authority only for monetary instruments underlying violations of the reporting requirements for internationally transported monetary instruments.

Finally, of major importance is revision to the Right to Financial Privacy Act (RFPA). The revisions to the RFPA contained in the Administration's money laundering bill can be considered as an adjunct to that bill, with application separate from the subject of criminal money laundering legislation or enforcement of the Bank Secrecy Act.

The most important and least controversial of the revisions is the amendment to subsection 1103(c) of the RFPA, 12 U.S.C. § 3403 (c). Currently, § 3403(c) provides that nothing in the Act shall preclude a financial institution from notifying a govenment authority that the institution has information "which may be relevant to a possible violation of any statute or regulation." The statute gives no guidance on what information can be given without running the risk of exposure to civil liability under the RFPA. The proposed amendment sets out explicitly that enough information can be given to enable Federal law enforcement authorities to proceed with legal process, e.g., summons, subpoena, or search warrant, in accordance with the RFPA. This information at a minimum must include the nature of the suspicious activity, the name of the customer, and other identifying information necessary to identify the customer or the account involved.

We believe you will find very little opposition in the financial community to this particular revision of the RFPA. The revision imposes no new legal duty on financial institutions, clarifies the right of financial institutions to act as good citizens without risk of civil liability, far outweighs any jeopardy to legitmate privacy interests, and would be of major assistance to Federal law enforcement.

For consistent application throughout the United States this amendment must be accompanied by the proposed preemption provision so that a financial institution that complies with the RFPA will not run afoul of any more restrictive state privacy law. The proposed clarification of the "good faith defense" to civil liability is also needed to protect financial institutions who cooperate with Federal law enforcement in good faith within the confines of the RFPA.

Regulatory Improvements

In addition to seeking legislation, Treasury has been discussing with the Department of Justice, and with the bureaus within Treasury responsible for Bank Secrecy Act compliance, possible improvements to the Bank Secrecy Act regulations. We have circulated a draft of these amendments within Treasury and will publish them as proposed regulations in the Federal Register in the near future.

As this Committee is aware, Treasury made a number of regulatory improvements to the Bank Secrecy Act regulations last year. This new set of proposals will be a continuation of our efforts to implement the Act as effectively as possible.

Mr. Chairman, this concludes my prepared remarks. I would be pleased to answer any questions you or the other members of the Committee may have.

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

FOR RELEASE AT 4:00 P.M. March 18, 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 27, 1986. This offering will result in a paydown for the Treasury of about $1,550 million, as the maturing bills total $15,162 million (including the 142-day cash management bills issued November 5, 1985, in the amount of $3,004 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 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 December 26, 1985, and to mature June 26, 1986 (CUSIP No. 912794 KM 5), currently outstanding in the amount of $7,629 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,800 million, to be dated March 27, 1986, and to mature September 25, 1986 (CUSIP No. 912794 LE 2).

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 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 $1,445 million as agents for foreign and international monetary authorities, and $2,924 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 RELEASE AT 4:00 P.M. March 18, 1986

TREASURY TO AUCTION 4-YEAR AND 7-YEAR NOTES
TOTALING $13,500 MILLION

The Treasury will raise about $9,750 million of new cash by issuing $7,000 million of 4-year notes and $6,500 million of 7-year notes. This offering will also refund $3,746 million of 4-year notes maturing March 31, 1986. The $3,746 million of maturing 4-year notes are those held by the public, including $437 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

In addition to the maturing 4-year notes, there are $8,348 million of maturing 2-year notes held by the public. The disposition of this latter amount was announced last 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 maturing securities held by Federal Reserve Banks for their own account may be refunded by issuing additional amounts of the new 2-year and 4-year notes at the average prices of accepted competitive tenders.

The $13,500 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 prices of accepted competitive tenders.

The Treasury Department announced that it will not offer the 20-year bond usually announced at this time in the quarter. In the absence of sufficient certainty that Congress will act soon on pending legislation to increase Treasury's bond authority, the Treasury decided to preserve its remaining authority for the 30-year bond tentatively scheduled for announcement on April 30. Treasury has used $191.6 billion of the present $200 billion authority to issue bonds (maturities over 10 years) without regard to the 4-1/4 percent ceiling on such issues. The remaining $8.4 billion is not enough to provide for reasonable amounts of both a 20-year bond and a 30-year bond; and the 30-year bond has been the more attractive issue in the market and thus less costly to the Treasury.

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

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Attachment

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
OF 4-YEAR AND 7-YEAR NOTES

March 18, 1986

Amount Offered to the Public	$7,000 million	$6,500 million
Description of Security:		
Term and type of security	4-year notes	7-year notes
Series and CUSIP designation	Series N-1990 (CUSIP No. 912827 TL 6)	Series F-1993 (CUSIP No. 912827 TM 4)
Issue date	March 31, 1986	April 3, 1986
Maturity date	March 31, 1990	April 15, 1993
Call date	No provision	No provision
Interest Rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction
Interest payment dates	September 30 and March 31	October 15 and April 15 (first payment on October 15, 1986)
Minimum denomination available	$1,000	$1,000
Terms of Sale:		
Method of sale	Yield auction	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%	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	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None	None
Payment through Treasury Tax and Loan (TT&L) Note Accounts	Acceptable for TT&L Note Option Depositaries	Acceptable for TT&L Note Option Depositaries
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment to be submitted with tender
Deposit guarantee by designated institutions	Acceptable	Acceptable
Key Dates:		
Receipt of tenders	Tuesday, March 25, 1986, prior to 1:00 p.m., EST	Wednesday, March 26, 1986, prior to 1:00 p.m., EST
Settlement (final payment due from institutions):		
a) cash or Federal funds	Monday, March 31, 1986	Thursday, April 3, 1986
b) readily-collectible check	Thursday, March 27, 1986	Tuesday, April 1, 1986

TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
March 18, 1986

STATEMENT OF THE HONORABLE JAMES A. BAKER, III

SECRETARY OF THE TREASURY

SENATE COMMITTEE ON APPROPRIATIONS

SUBCOMMITTEE ON TREASURY, POSTAL SERVICE,

AND GENERAL GOVERNMENT

MARCH 18, 1986

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE:

I am pleased to appear before this Subcommittee to discuss the operating budget for the Treasury Department for Fiscal Year 1987.

Last month, I appeared before the Senate Budget Committee as one of the President's chief economic spokesmen. We discussed the economy and the Federal Budget. I underscored the importance of a growing economy to improving the budget picture and pointed out that during the current expansion, strong economic growth has been achieved with much less inflation than in the late 1970's. We must strive to extend that good record into the future. Continued economic expansion will require reducing the deficit and balancing the budget by FY 1991. This will not be easy, but the effort deserves strong bipartisan support.

Today I am before you, not as economic spokesman, but as the chief operating officer of one of the Nation's major departments.

For instance, we administer the Nation's tax system, and collect the government's revenues. We manage the government's fiscal affairs, including paying its bills and financing its debt. We manufacture the Nation's currency and coin. We help regulate our country's financial institutions. We process passengers and cargo coming into the country and enforce both import and export laws. We carry out basic federal law enforcement responsibilities, including protecting the President and Vice-President. We participate in efforts to combat illegal drug trafficking, and administer firearms and explosives laws. Finally, we advise the President on monetary, economic, financial and tax policies.

In order to continue to carry out these essential governmental functions, we are requesting a total FY 1987 budget for the Department of the Treasury of $6.0 billion and 129,127 FTE positions. (These funding and staffing totals include $5.6 million and 75 positions for the orderly shut-down of the General Revenue Sharing program. The Appropriations Subcommittee for Housing and Urban Development and Independent Agencies is reviewing that request.)

Our FY 1987 budget request for Treasury operating programs represents an increase of $364 million, or 6.5 percent above the proposed level for FY 1986.

In addition to the request for Treasury operating programs, the FY 1987 Budget includes proposed legislation for $78 million and 1,664 FTE in order to provide for the management and liquidation of the Small Business Administration loan portfolio. This relates to the proposed termination of the Small Business Administration as reflected in the President's Budget. It is our understanding that this request will be taken up by the Commerce, Justice, and State Subcommittee.

Our budget has seven major objectives:

I. At the top of the list is protecting the integrity of the tax administration system.

The experiences of the 1985 tax filing season were deeply troubling to the Department and a source of great frustration to the taxpaying public. It is my belief that a recurrence of the problems that plagued the IRS last year would have a corrosive effect on our society and a devastating impact on the willingness of our citizens to comply with the system. This erosion of public confidence has a big price tag: a one percent drop in voluntary compliance results in a revenue loss of almost $6 billion. This is clearly a case where an ounce of prevention is worth a pound of cure.

We have reviewed closely the requirements for tax processing and taxpayer service and have developed appropriate requests for FY 1986 and FY 1987 to address these needs. We have designed our budget requests to revitalize the tax system and restore public confidence in its effectiveness. We learned a lesson from last year and intend to ensure adequate funding and to stretch each dollar to its fullest.

At this point, Mr. Chairman, I'd like to emphasize the importance of timely consideration of the IRS supplemental. As you know, we have submitted a $340 million supplemental request for FY 1986. The supplemental will:

- improve the quality of tax processing operations through more management oversight and employee training;
- increase service center staffing to stay current with the work load; and
- provide taxpayer service levels that are responsive to taxpayer requests for information and account status.

Mr. Chairman, I cannot overstate the importance of the supplemental funds to IRS operations both now and in the foreseeable future. In order to maintain current activity levels and allow for the logistical continuity of operations, prompt action on the full amount of the request is critical.

II. Our second objective is to strengthen the capability of the IRS to promote tax compliance and generate revenue.

In FY 1986, the supplemental request will enhance the following enforcement and revenue producing activities:

- o hiring and training of audit staff in advance for a major drive to increase tax revenues in FY 1987 as part of a three-year revenue initiative;
- o increased actions against abusive tax shelters and attention to currency transaction reports; and
- o assistance to states in carrying out audits of foreign and domestic activities of multinational firms.

In FY 1987, we intend to build a stronger and more credible deterrent against noncompliance with tax laws. In FY 1985, IRS faced an estimated tax gap -- taxes owed but not paid -- of over $100 billion. This gap has risen from $29 billion in 1973, when the IRS first began estimating it. This continued erosion of our receipts base through noncompliance undermines the confidence of the general taxpayer and needlessly adds to the budget deficit.

The cornerstone of the request is the previously mentioned revenue initiative which will yield $10 billion by FY 1991. We are also seeking funds for other high-yielding activities. These include faster litigation of pending tax shelter cases to reduce case backlog and the resolution of unreported income cases disclosed through the document matching program.

III. Our third budget objective is to meet our law enforcement and protection responsibilities.

The FY 1987 budget for Customs provides for stabilization of the investment in drug interdiction and overall staffing levels at approximately the 1985 level. The requested funds will permit Customs to:

- o enforce our Nation's import and export laws through the processing of over seven million entries of merchandise, 93 million carriers and nearly 300 million passengers;
- o collect over $15 billion in revenue; and
- o operate the recently acquired tools to combat drug trafficking.

The requested funding for the Secret Service will help us prepare for the 1988 Presidential campaign and protect foreign dignitaries visiting the 1987 Pan American Games. The Service will acquire sophisticated equipment to better support its protective efforts.

The Bureau of Alcohol, Tobacco, and Firearms' budget will continue efforts to ensure the collection of all alcohol and tobacco excise taxes and to reduce the criminal use of firearms and explosives. We estimate BATF revenue collections at approximately $10 billion in FY 1987.

In FY 1987 the Federal Law Enforcement Training Center will institute a new policy of funding only the direct costs of basic training. Participating organizations will assume responsibility for the respective costs of the students' travel, meals and lodging.

IV. The fourth budget objective is to supply the resources necessary to manage the Nation's finances and service the Nation's debt. This includes:

- o continuing the Administration's efforts to improve cash and credit management; and
- o putting into operation the "Treasury Direct" System for the issuance of marketable securities to individual investors.

V. Fifth, we must ensure adequate currency and coin to meet the Nation's demands. The requests for the U.S. Mint and the Bureau of Engraving and Printing will accomplish this objective.

VI. Sixth, we must provide for appropriate policy formulation and management oversight of Departmental operations. The Department develops and carries out the Nation's economic, financial and tax policies. In recognition of the Department's critical role in the Nation's economic affairs, the President has given the Department responsibility for chairing his Economic Policy Council.

As you are well aware, we are spearheading tax reform. The President believes that tax reform is of the highest priority; our tax system must be simpler, fairer and encourage economic growth. The Department is also advancing an initiative for sustained economic growth to help developing countries cope with their debt service problems.

Last fall, in conjunction with the other G-5 countries, we initiated actions to improve the U.S. trade deficit by bringing an overvalued dollar into better balance with their currencies. As a follow-on to those initiatives, the President has directed the Department to determine if a more comprehensive restructuring of international monetary relationships should be discussed with other nations.

VII. Finally, Treasury's budget continues the critical modernization efforts begun in previous years. We believe that investments in information systems pay off generously in increased efficiency over the long run. For example:

- For the IRS, requested funds will continue the Automated Examination System. The increased productivity from this initiative will enable IRS to collect additional net revenue of $5.1 billion through 1991.
- In the Customs Service, we need to move forward with development of the Automated Commercial System (ACS) and the Treasury Enforcement Communications System (TECS II). These systems will enhance productivity and effectiveness.

- In the fiscal services, we will continue to modernize the government's disbursement and collection systems, relying on electronic systems as opposed to inefficient and costly paper-based procedures.

In summary, our $6.0 billion request for the Department of the Treasury represents:

- a necessary investment in the IRS to preserve the integrity of the tax system;
- a prudent investment in the IRS to increase tax compliance and consequently make a major contribution to deficit reduction; and
- the responsible preservation of the essential governmental functions of the Department.

Mr. Chairman, that concludes my opening remarks. I shall be happy to answer any questions that you or the other Subcommittee members may have.

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TREASURY NEWS

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

For Immediate Release
March 19, 1986

Contact: Bob Levine
Phone: (202) 566-2041

TREASURY AUTHORIZES EXIMBANK TO MATCH BRAZILIAN SUBSIDIES

Secretary of the Treasury James A. Baker, III has authorized the Export-Import Bank of the United States to support a sale in the U.S. market by a domestic producer facing heavily subsidized financing in dollars from the Government of Brazil.

In authorizing the Eximbank action, Secretary Baker expressed concern at the apparently increasing use by the Brazilian Government of subsidized financing to support exports to the United States.

"We have noted instances of such export subsidies for general aviation aircraft and other products, as well as in the present case," the Secretary said. "While we are sympathetic to Brazil's need to export, it doesn't need these subsidies in source of harm to U.S. trade interests, and make it more difficult for the United States to keep its market open. Moreover, given Brazil's debt problems, we wonder whether such export subsidies to industrialized countries are appropriate."

Under Section 1912 of the Export-Import Bank Act, the Secretary found that the Brazilian financing would be "a significant factor" in the sale. Further, the Brazilian Government declined to withdraw the subsidies when requested to do so. He therefore authorized the Bank to make a matching offer to Allis Chalmers.

Allis Chalmers Hydro, of York, Pennsylvania, is bidding to supply hydroelectric power generating equipment for two stations on the Allegheny River new Pittsburgh. Allis Chalmers faced a competing bid from Voight S.A. of Sao Paulo, Brazil, supported by Brazilian Government export financing at 5% interest.

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TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
Expected at 9:30 a.m.
March 20, 1986

TESTIMONY OF THE HONORABLE
GEORGE D. GOULD
UNDER SECRETARY FOR FINANCE
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
THURSDAY, MARCH 20, 1986

Mr. Chairman and Members of the Distinguished Subcommittee:

I compliment the Chairman for calling these hearings on the condition of depository institutions, and I greatly appreciate this opportunity to appear before your Subcommittee.

We share your keen interest in this subject and have been working on many aspects of it -- involving different types of depositories, various lending markets, and both short- and long-range implications for consumers, small savers, borrowers, and the health of the depositories themselves.

I recognize that all of us may not see eye-to-eye on how to serve the American public best on each and every one of these issues. But I honestly believe we share much ground on a number of matters, particularly relating to the thrift industry. I am hopeful we can work together on these subjects for the common good.

My statement addresses four topics. First, as the Chairman requested, we have examined closely the problems of the thrifts and FSLIC. I would like today to outline our analysis and the elements of a proposal we are developing with the Bank Board and the Federal Home Loan Banks. The industry groups have expressed general agreement with key aspects of this approach.

Second, I will discuss briefly the problems of agricultural banks and the recent joint statement of the three banking agencies on regulatory policies toward agricultural lenders.

Third, my statement touches on some operational deposit insurance issues -- related specifically to how we might increase the fairness and effectiveness of the FDIC's operations.

Fourth, I would like to say a few words about the general prospects of the nation's insured depository institutions and their ability to serve consumers, savers, businesses, and themselves. Neither Congress nor the Administration can afford a total preoccupation with immediate issues to the detriment of the not-too-long-term health of American banking organizations. Otherwise, our nation's banks will face economic obsolescence, consumers and other customers will be served less well, our system of banking regulation and supervision will fall behind the marketplace, and the deposit insurance funds will be at greater risk.

I am pleased to add that we have been working closely with our colleagues in the regulatory agencies on these issues. I understand they will address some of your more specific questions on the condition of banks in various lending areas in their statements later in these hearings.

I. The Problems of the Thrifts and FSLIC

The Chairman and many members of this Subcommittee have stressed that the problems of the thrifts and FSLIC comprise the most important deposit insurance issue. The Administration assigns this subject an equal priority.

Indeed, given the decline in interest rates and the current substantial profits of many thrifts, this is a propitious time to make headway. We have worked closely with Chairman Gray to develop a sound proposal. While we need to resolve some significant details in coming weeks, I would like to report to you today on: (1) estimates of the size of the problem; (2) the limits of FSLIC's current resources; and (3) our three-part 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. Last week, before this Subcommittee, Chairman Gray appraised the resolution costs at approximately $16 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 (involving thrifts with $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 investment by or borrowing from the Federal Home Loan Banks. In effect, FSLIC could draw against its future stream of assessment and investment income, and some of the FHLBanks' future profits, 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 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. Public officials and private businesspeople from some of your states have made this point to us, too. 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

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 investments and borrowing 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, now 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 (December 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. The preferred stock option is preferable because it both increases FSLIC's accounting reserves and provides a budget offset for FSLIC's case resolution outlays. However, authorizing legislation is probably 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 recently 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, are seeking to arrange a FHLBank financing package that taps the Banks' skills and resources responsible.

3. Expand the Acquisition Program for Ailing Thrifts

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.

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?

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 firms with securities affiliates, cannot be accommodated in some fashion. Perhaps certain restrictions on affiliate transactions and conflicts of interest may suffice. In addition, some proposals before the House, 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.

Finally, I should explain how our support for consumer banks is completely consistent with, and indeed reinforces, our effort to expand the acquisition market for ailing thrifts. As the Treasury has stated in the past, we would consider closing the nonbank bank loophole in the context of comprehensive legislation. That legislation would have to include provisions to reduce the statutory and regulatory barriers that currently exist for potential thrift acquirers. That is the only way we can really channel potential consumer bank entrants toward troubled thrifts -- so as to reduce FSLIC's costs, bring new capital into the thrift industry, and continue to offer more competitive and better services for working people of modest means.

Those who argue that they want to encourage thrift acquisitions by closing down consumer banks alone are pursuing quite a different agenda. They do not want the competition from new entrants, and to this end they are willing to cut off valuable new providers of services to the middle class. Indeed, legislation pending in the House reflects this approach: Not only would the bill halt the consumer bank movement, but it would severely discourage thrift acquisitions and tie the hands of thrift owners who want to market more services to small savers.

Summary on Thrifts

The time is ripe to make major advances on the problems of the thrifts and FSLIC. Public confidence in FSLIC and the thrifts requires all of us to come together to take action now.

Mr. Chairman, you have been alert to these issues. You have asked us for a plan, and we are presenting one -- together with the Bank Board, the FHLBanks, and substantial industry support. We know you are ready and willing to act on the right program. We would like to work closely with you and the Members of this Subcommittee as we refine the details over the next few weeks. Then together we can take expeditious action to strengthen FSLIC, this important industry, and the faith of depositors throughout the nation.

II. Agricultural Banks

American agriculture is undergoing a major transition. This transition is critical if we expect to compete effectively for export markets. The new Farm Bill authorizes expenditures of at least $50 billion over the next few years to ease the way. The lower dollar and lower interest rates will help, too.

Nevertheless, current USDA economic projections anticipate several more years of significant pressure on many farmers, rural communities, and agricultural lending institutions. We believe, therefore, that it is critical for the bank regulators to continue to work constructively with farm banks on their problems and the concerns of their borrowers. The regulators' joint statement of March 11, which I have attached to this testimony, is exactly the type of effort we need.

A. 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. Commercial banks hold about $48 billion in direct farm loans.** The almost 4000 agricultural banks hold about $24 billion of this agricultural debt.

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, only 1 percent of the agricultural banks had reported capital-to-asset ratios below 6 percent. (Fifty percent had reported capital of over 10 percent; 37 percent had reported capital between 8 and 10 percent, and 12 percent had reported capital between 6 and 8 percent.) As a group, agricultural banks' 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.

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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.

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 before another Subcommittee of this Committee that 40 of the 50 agricultural banks that had failed as of that time had been reopened -- either as freestanding 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.

B. Relief for Agricultural Banks and Their Borrowers

Recent initiatives, both statutory and regulatory, should provide some relief to agricultural banks and their borrowers.

The 1985 Farm Bill, enacted into law on December 23, establishes a $490 million interest rate reduction program for loans made by commercial banks and guaranteed by the Farmers' Home Administration (FmHA). Under this program, a commercial lender must reduce the interest rate on a farm loan to enable the farmer to attain a positive cash flow. Then USDA can contribute as much as 50 percent of the cost of the rate reduction, up to a total Government "rate buydown" of two percent. FmHA published regulations for this new expenditure program in late February, so it is available for farmers and bankers now.

On March 11, the Federal Reserve Board, the FDIC, and the Office of the Comptroller of the Currency issued a joint statement on regulatory policies toward agricultural lenders. This statement explains that "the banking agencies believe it appropriate to employ supervisory policies that will assist basically sound, well-managed banks to weather this transitional period, consistent with the need to maintain an adequate supervisory framework and the credibility of regulatory and public financial statements."

To alleviate the strains on farm lenders, the banking agencies committed to pursue four policies immediately.

First, they will allow a bank experiencing difficulties to operate below the minimum capital requirement, provided the bank has the capacity to restore its capital within five years. In effect, this policy recognizes that a primary purpose of capital is to absorb unanticipated losses: Agricultural banks with respectable prospects of recovery should now be able to draw on their traditionally high levels of capital. The OCC has outlined a special capital forbearance approach for implementing this policy.

Second, the banking agencies reaffirm their intent to accommodate banks that forbear on farm loans through appropriate debt restructurings. It is in everyone's financial interest to keep a farmer on his or her land if there is a reasonable prospect of repayment.

Third, the regulators will make available and encourage the appropriate use of Financial Accounting Standards Board Statement No. 15 (FASB 15) for troubled loan restructurings. FASB 15 can help bankers avoid an automatic charge-off of losses on certain restructured loans, even where there have been notable concessions in financing terms.

In brief, FASB 15 allows financial institutions to maintain the value of a restructured credit, provided that the total anticipated future cash receipts (both principal and interest) at least equal the principal value of the loan. (The anticipated future receipts must be both probable and reasonably anticipated.) This technique should be especially appealing because it helps the farmer stay afloat along with the lender; both need to come to terms to restructure a loan satisfactorily.

Fourth, the banking agencies propose to modify their reporting and disclosure requirements to separate performing renegotiated debt from nonperforming loans.

Finally, I should note that the regulators informed the Senate Banking Committee that the last three of these policies would also be available to lenders holding energy and other loans. The OCC and the FDIC are undertaking an expedited analysis to determine whether the capital forbearance policy also need be applied to energy lenders in some fashion.

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.

The emergency acquisition provisions of the Garn-St Germain Act of 1982 provide some flexibility to maintain credit services to areas served by failed banks. But they incorporate significant restrictions that hamper regulators' efforts to solve problem cases: 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. We have been working with the banking regulators to propose adjustments that Congress can make at the time of extension. We basically concur with Chairman Seidman's recent recommendations to: permit acquisitions of "failing" banks (already the case for thrifts); reduce the $500 million asset limit, perhaps to $250 million; and authorize the acquisition of a bank holding company where one or more bank(s) in the system is in danger of failing, the bank(s) satisfy the size test, and the failing bank(s) account for a significant share of the holding company's assets. It would also be beneficial if an acquired bank could be operated as a branch instead of as a separate institution.

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.

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.

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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.

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 finances of the depositors. I have discussed such a "failure management" program in the context of FSLIC and the thrifts. Chairman Seidman has also outlined 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 Subcommittee to enhance the FDIC's ability to protect depositors and the financial system.

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.

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. 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 Subcommittee in meeting the challenge.

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

We have outlined today some major and minor proposals to handle the problems of the thrifts and FSLIC, agricultural banks, and the FDIC's "failure management." But I would be remiss if I stopped with those immediate problems.

It is also vitally important that we ensure banks' ability to operate in a fast-changing marketplace -- both to promote their safety and soundness and to supply more and better services to consumers and other customers. Too often in the past, the debate on change in the banking world has focused on the need to expand their "powers" vis-a-vis others, without much discussion of why this expansion is necessary. The debate broke down into an unappealing exchange over "who gets what," particularly in relation to the powerful securities firms.

We believe that we have a duty to explain to Congress why expanded banking services will result in a more secure banking system that can be responsive to the needs of consumers, state and local governments, and America's various businesses. If Congress will not permit banks to evolve with their market, we ultimately will create a much bigger deposit insurance problem than any I have discussed today.

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 debt, 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 portfolios. 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 the Senate 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.

Banking organizations, particularly small ones, 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.

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 how those used to the system that prevailed before communications-computer technology and consumer-saver preferences opened up the marketplace have arrived at this position.

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. 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.

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 introduced in the House 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 being ineffective in the face of 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.

V. Conclusion

I would like to work closely with this Subcommittee to address some pressing problems we all recognize. We acknowledge that in a short legislative year, with many issues competing for the Congress' attention, any other approach is likely to result in stalemate.

I believe the difficulties of the thrifts and FSLIC are especially worthy of joint action. We can make a start alone, but we can accomplish much more with your help.

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.

Attachment A

FSLIC-Insured Institutions
(September 30, 1985)

		Insolvent			Low Net Worth - 0-3% of Assets			Total - 3% Net Worth or Less		
	All	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.

Joint Statement of the Federal Reserve Board,
the Federal Deposit Insurance Corporation and
the Office of the Comptroller of the Currency
on Regulatory Policies Toward Agricultural Lenders

The Federal bank regulatory agencies are fully aware of the problems in the agricultural sector of our economy and the financial strains these problems have created for borrowers and lenders. In light of these conditions, the banking agencies believe it appropriate to employ supervisory policies that will assist basically sound, well-managed banks to weather this transitional period, consistent with the need to maintain an adequate supervisory framework and the credibility of regulatory and public financial statements. Supervisory and regulatory policies to help achieve these objectives are outlined below.

In addition to the regulatory policies contained in this statement, the banking agencies continue to urge the Congress and state legislatures to take steps to help maintain the provision of banking services in small communities. The Garn – St Germain Act of 1982 prohibits acquisitions across state lines of troubled banks before they have failed and of failed banks with assets under $500 million. The banking agencies believe that these two constraints should be eased by allowing failing bank acquisitions across state lines and by reducing the size criteria so as to maintain the banking services in farm communities. An easing of state restrictions on branching could also help maintain banking services in small towns in cases when a separately organized and capitalized bank might not be viable.

In order to help alleviate strains on farm lenders and provide additional time to resolve problems in the agricultural sector, the banking agencies express their support for and commitment to the following supervisory policies and principles:

- A major function of capital is to absorb unanticipated losses and help an organization weather a period of adversity. Heavy losses may reduce a bank's capital below normal levels or below minimum regulatory guidelines. The banking agencies will allow a bank experiencing difficulties to operate below the minimum capital requirement provided the bank has the capacity to restore capital within five years.

- The banking agencies reaffirm their policies not to discourage banks from forbearing on farm loans through appropriate debt restructurings, recognizing that such restructurings may be in the interests of both the bank and the borrower when there is a reasonable prospect that the borrower will eventually be able to repay the loan.

- Consistent with their general view toward forbearance, the banking agencies will continue not to require an automatic charge-off of loans that have been restructured. Generally accepted accounting principles, as set forth in Financial Accounting Standard No. 15 (Accounting by Debtors and Creditors for Troubled Debt Restructurings), allow financial institutions to maintain the value of a restructured credit provided that the total of anticipated future cash receipts under the new modified terms which are both probable and can be reasonably estimated at least equals the principal value of the loan. Thus generally accepted accounting principles do not necessarily require the immediate charge-off of loans or portions of loans that have been restructured in accordance with that rule.

- The banking agencies see no compelling reason for interpreting or reporting renegotiated debt with nonperforming loans. In line with this view, the agencies propose to modify regulatory reporting and disclosure requirements for restructured debt so that such debt, if it is performing in accordance with the new terms, would be designated as loans "Restructured and In Compliance With Modified Terms."

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

FOR RELEASE UPON DELIVERY
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STATEMENT BY
THE HONORABLE DAVID C. MULFORD
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT INSTITUTIONS
AND FINANCE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
MARCH 20, 1986

Mr. Chairman, Members of the Committee, thank you for inviting me to discuss the U.S. debt initiative and where it stands. The draft bill you have sent offers several relevant suggestions which I would also like to discuss. But I would like to stress at the outset that the Administration does not see a need for legislation at this time to implement our debt initiative.

The current international debt crisis is one of the greatest challenges for the world economy and financial system since the Great Depression. It has that element of insolubility which brings out our worst frustrations.

The U.S. economy has been seriously and adversely affected by the debt situation. U.S. exports to the developing countries have slumped. Our financial institutions have had to bolster their reserves. And the demands on the Federal Budget for foreign assistance have intensified. If we manage the debt situation responsibly and wisely, these adverse effects should recede in the future.

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 where we can be effective.

Herein lies the importance of the U.S. debt initiative. It recognizes the fundamental need for growth. It places the objective of increased growth and the reforms necessary to promote growth at the center of the debt strategy.

We believe that without growth there can be no solution to the debt problem. Countries must expand their debt servicing capability -- real income and export earnings -- at a faster pace than they are accumulating debt.

We also firmly believe that without economic reform, no amount of money -- whether derived from external borrowing, foreign assistance, or inflationary domestic pump-priming -- will produce sustained growth.

Credible reform by the debtor nations will improve their growth prospects, but debtor nations simply cannot be expected to grow and adjust simultaneously without additional external finance. Linked with credible reform, the other two elements of the debt initiative provide for the sources of this finance: net new lending by the commercial banks and enhanced flows from the international financial institutions. These three mutually reinforcing elements form the working heart of the debt initiative.

It is also important to emphasize that the debt initiative does not operate in a vacuum or in isolation from other critical economic issues. Recent developments in the global economic environment are improving prospects for developing countries and for our own economy:

-- There has been a substantial reduction in interest rates. LIBOR currently stands at approximately 7.6 percent, as compared to 10.2 percent a year ago. Each percentage point decline has reduced the debt service on commercial loans to the fifteen major debtor nations by $2.5 to $3 billion.

-- The dramatic decline in crude oil prices gives most developing countries financial relief on their oil imports, impetus to exports from the estimated one percent increase in OECD growth, and additional interest rate relief as inflationary expectations subside further. We are already seeing the interest rates fall in some major industrialized countries.

-- Even some of the oil exporting countries will be offsetting their lost export earnings with reduced interest rate costs.

-- The 25 to 30 percent decline since September in the U.S. dollar versus the yen and deutsche mark should make imports from the United States more competitively priced in all developing country markets. Export opportunities should also improve for those economies whose exchange rates track closely with movements in the dollar.

There are good prospects for additional steps in the coming months which can add impetus to growth. First, the United States is implementing a credible deficit reduction program. All Branches of the U.S. Government recognize that we must get the U.S. deficit under control. Suggestions that involve budgetary outlays such as increasing purchases for the Strategic Petroleum Reserve should be viewed in that context. While they may have beneficial effects, they would require additional budget outlays and they further complicate the already difficult decisions which the President and the Congress will be facing in the coming weeks.

Second, the Congress and the Executive Branch are deeply engaged in tax reform, which can give impetus to private sector growth and initiative.

Third, the U.S. trade deficit in 1986 should be about $20 billion lower than we expected as recently as last fall. For 1987, the deficit should drop below $100 billion. This can be accomplished without resorting to protectionist solutions and with continued solid growth in the U.S. economy.

If other key industrial nations do their part -- improving domestically generated growth, maintaining or improving access to markets, and continuing the economic and financial cooperation of recent months -- I see greater scope for continued growth, reduced inflation and further reductions in interest rates over time.

The rapidly approaching meetings of the Interim and Development Committees, the OECD Ministerial Meeting and the Tokyo Economic Summit will be opportunities to continue cooperation on these matters so important to resolving the debt situation in developing countries.

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 credible, growth-oriented reform in the debtor countries, supported by net new lending by the commercial banks and enhanced by policy-based lending from the international financial institutions is essential. 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.

The initiative is now in place and is being implemented. What must happen now to make the strategy work?

First, the debtor nations must reform their economies so that they can grow. While there have been commendable efforts to deal with the debt problems during the past three years, 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. The debtor nations will need to examine intensely opportunities for 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.

We have heard the suggestion that trade liberalization should play a central role in reform efforts. While this is often true, I would stress that reforms must be tailored to the situation of each debtor nation. No single element should be seen as a necessity for policy-based lending from the development banks. Nor should the United States seek to impose its own bilateral trade objectives on these loans. That would be counterproductive.

Our first goal needs to be to encourage economic reform which will generate growth and relieve debt constraints, and in some cases, liberalization of restrictive trade practices is important. However, finance needed to support reform will only be made available if these reforms are credible, with reasonable prospects for long-term success.

Second, 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 debtor nations. If reform in the debtor countries is 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.

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.

It is also suggested that we consider changes in the structure of U.S. capital markets or the regulation of private financial institutions in order to achieve a lasting resolution of the debt crisis.

I do not believe this is necessary at this time. Indeed, it could be counterproductive, because it suggests some form of generalized changes in U.S. practice can bring about a lasting solution to the debt crisis.

The changes that are necessary in large degree are external to the United States: adjustment by the debtor nations, support from the IMF and increased lending from the commercial banks and the MDBs. Changes in U.S. banking regulations will not reestablish the creditworthiness of countries, provide the new financing necessary to promote growth, nor instill the confidence necessary in domestic populations to lead to a return of flight capital.

The heads of the U.S. regulatory agencies already are on record as stating that new lending to countries making appropriate adjustment efforts can improve the quality of outstanding loans. I believe that the U.S. financial system and U.S. regulatory agencies are sufficiently flexible that they can accommodate and deal with specific issues on a case by case basis, as they arise.

The commercial banks are being called upon to increase their exposure by a modest 2.5 to 3 percent annually, while the World Bank is being asked to increase its lending by an amount equivalent to an annual increase in total exposure of about 20 percent. The provision to commercial banks of World Bank guarantees or of some sharing of the Bank's "preferred creditor" status through subtly crafted cofinancing arrangements would essentially transfer risk to governments, voiding the modest increase in commercial banks exposure. While the desire for such measures is understandable, we do not intend to support them to induce increased bank lending.

This brings me to the third element of the debt initiative, the contribution from the international financial institutions. I would underscore at the outset that the IMF must continue to play its central 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 contributions will necessarily focus on macroeconomic policy, rather than long-term structural reforms.

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.

An expanded role for the World Bank will 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 quality of conditionality of lending with the World Bank if sectoral lending is to be increased. Any increase in fast-disbursing lending by the Bank which fails to maintain loan quality will result in a serious risk of over-exposure and a diminished international credit standing for this important international institution.

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.

The expanded role for the World Bank in the debt initiative is not limited to policy-based lending. An important element of economic reform in almost all debtor nations is the need to strengthen the role of the private sector. A major World Bank tool for this purpose is the proposed Multilateral Investment Guarantee Agency, or the "MIGA."

The MIGA is 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.

The United States has long been an advocate of a greater role for foreign direct investment in the development process. Foreign direct investment both enhances the private sector's role and encourages the flow of non-debt capital, which can expand productive capacities and facilitate the structural changes which are essential to resolving the debt problem. Despite its advantages, foreign direct investment declined from 20.4 percent of total capital flows to developing countries in 1975 to 10 percent in 1984.

Perceptions by investors of restrictive investment policies, especially uncertainties about the transfer of returns on investments, appear to have contributed to the reduction in direct investment flows. Policies that distort or impede international investment flows conflict with the obvious needs of developing countries for capital. The MIGA, with its strong mandate to encourage reforms, will stimulate the flow of foreign direct investment to these countries.

I understand that you have received the Administration's legislative proposal, but there is real reluctance to initiate a new program in the current budgetary environment. Let me emphasize that the impetus to achieve this long sought U.S. objective should not be dissipated by waiting. A delay would disrupt the international efforts now underway to encourage the flow of equity investment to developing countries. The MIGA clearly advances our interests: it supports our development policy, reinforces our international debt strategy and will result in further investment flows to the developing nations. Early authorization for U.S. membership and full funding is important to the success of our overall international efforts. Your support is essential.

I should touch on another key funding question related to the World Bank before turning to other matters. We are prepared, if all the participants in the debt strategy do their part and there is a demonstrated increase in the demand for quality lending, to consider a general capital increase for the World Bank. This Committee will carry the responsibility for convincing your colleagues in the House that any such capital increase is justified. We will need your guidance and views during negotiations of this subject, if conditions emerge which warrant consideration of a capital increase.

An alternative to a capital increase which has been advanced is a change in the gearing ratio of the Bank. Presently, the Bank can not have outstanding disbursements in excess of subscribed capital, reserves and surplus. We oppose any change in this limitation. We would cite three simple reasons.

First, the change in the gearing ratio would be a fundamental change in the nature and amount of financial resources which stand behind the securities offered by the Bank to investors. Bluntly:

-- we would risk raising the cost of funds to the Bank and the cost of Bank loans to all borrowers, and

-- we would risk reducing the pool of investors prepared to invest in Bank securities to the point where

-- we are uncertain that even the existing lending program could be funded.

Second, the timing could not be less propitious. With our support the Bank is currently modifying the nature of its lending operations fundamentally. Investors see that a growing portion of Bank loans are going to support policy changes, rather than infrastructure projects which promise to earn foreign exchange. While we support this shift because it promises the most effective means of dealing with the debt situation, we can understand that investors may be watching carefully. To add a fundamental change in the Bank's financial structure which diminishes the relative amount of shareholder resources at risk would be highly imprudent.

Third, the budgetary savings which presumably would be the point of the gearing ratio change can be achieved by making subscriptions in the form of callable capital which do not necessarily entail budget outlays. It would be premature to discuss now the need for additional capital. But callable capital is well-understood by the investment community, raises none of the disadvantages of a gearing ratio change and, if there is no paid-in element, has no impact on the Federal budget. In short, I see no advantage -- practical or theoretical -- to a gearing ratio change, when compared to callable capital.

Several other suggestions for changes in the World Bank are useful contributions. First, we can support an increase in the amount of structural adjustment lending. The ten percent ceiling is not a barrier. We are prepared to see it raised to accommodate the demand for well-conditioned loans designed to support reform programs.

Second, the idea of increasing the World Bank share of already approved, but unfinished projects was a prominent element of the Special Action Program in effect in 1983 and 1984. It may be appropriate in specific cases. However, if the purpose is to provide more foreign exchange in an appropriate policy context, the structural and sectoral adjustment lending programs can meet the same need without complicating project accounting and implementation.

Finally, I agree with the suggestion that reforming financial sectors can play a key role in several debtor nations. Clearly, sensitive political issues are involved and each country situation needs to be evaluated individually.

Before concluding my thoughts on the debt initiative, I want to touch on the role of the Inter-American Development Bank. As you know, Mr. Chairman, we are seeking a number of specific reforms in the replenishment negotiations for the Bank. These reforms -- directed toward enhancing the Bank's ability to identify and negotiate appropriate policy conditions for its lending -- are essential if the Bank is to play a meaningful role in resolving the debt problems of borrowing countries in the region. We are hopeful that we can make significant progress on these points next week, as member countries convene for the Bank Annual Meeting in San Jose, Costa Rica.

To put in place the financial underpinnings for future Bank lending, the member governments have negotiated a merger of the Ordinary Capital and Inter-Regional Capital accounts of the Bank. This merger will allow more efficient use of Bank capital. In other words, the Bank will be able to lend on the basis of a smaller increment of capital subscriptions from members, than if the two accounts were to remain separate. U.S. agreement to the proposal requires legislative action, and I urge your prompt and favorable consideration.

Let me summarize by saying that if the U.S. initiative succeeds, we will see 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 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.

Before concluding, I would like to add a somewhat related comment.

I understand that you are contemplating requirements for a series of reports on a number of topics. Mr. Chairman, I can only say that Gramm-Rudman-Hollings is real and its effects on the Treasury Department are real. Some weeks ago, I asked my staff to analyze existing reporting requirements to see which ones can be eliminated. We have several proposals. In this climate, the thought of doing additional reports does not seem realistic unless their legislative purpose is immediate. I and my staff stand ready to meet with the Committee formally or informally at the call of the Chair. But the expense of written reports would be hard for us to justify.

With this plea to you to cooperate with our efforts to reduce expenditures, I now look forward to hearing your views on the debt initiative and to answering questions you may have.

Thank you.

TREASURY NEWS

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FOR RELEASE UPON DELIVERY
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Department of the Treasury
United States Secret Service
Introductory Statement of
David D. Queen
Acting Assistant Secretary
(Enforcement and Operations)
For Presentation to the Subcommittee on Treasury
Postal Service and General Government
Committee on Appropriations
United States Senate

Mr. Chairman and Members of the Committee:

It is a pleasure for me to appear before you in support of the annual appropriation request for the United States Secret Service. I am testifying because Assistant Secretary Keating is unable to be here today. He is traveling with the Attorney General on a factfinding mission to Thailand, Burma, India and Pakistan, to investigate the problem of drug trafficking in and through that region.

Appearing with me today are the Director of the Secret Service, John R. Simpson, key Secret Service staff members, and Jill E. Kent, Deputy Assistant Secretary for Departmental Finance and Planning.

The budget request for fiscal year 1987 is 307,140,000 dollars. These funds are needed to carry out the vital missions of the U.S. Secret Service, which include protection of the President, Vice President, and foreign heads of state. As you know, Mr. Chairman, the U.S. Secret Service also has a critical investigative mission in protecting the currency against counterfeiting and in investigating credit card fraud, computer fraud, and the theft and forgery of government obligations. The Secret Service has carried out these missions with determination and enthusiasm.

Protection continues to be the Secret Service's highest priority. During fiscal year 1985, the Secret Service expended more man-hours in protection than in any past non-campaign year. The man-hours devoted to the protective mission represented 58 percent of the total for fiscal year 1985. Just as fiscal year 1985 included the close of the Presidential campaign and the Presidential Inauguration, fiscal year 1986 started off with a major special event, the United Nation's 40th General Assembly, for which the Secret Service planned and carried out a challenging protective function. During the period of late September 1985 to October 30, 1985, over 100 heads of state visited New York City for this event. From all reports, the Secret Service did an outstanding job and are to be commended for this fine

As we look to the future, we see that these special events are becoming more numerous. In July of fiscal year 1986, the Statute of Liberty Celebration will take place, no doubt attended by many foreign VIP's. During fiscal year 1987, the Pan American Games will be held in Indianapolis. In the spring of fiscal year 1987, Pope John Paul II is scheduled to visit our country. Events such as these pose enormous challenges for the Secret Service, especially in view of the threat of terrorism. Careful and detailed planning, meticulous training and preparation, and continued support and cooperation from local, state and other Federal law enforcement agencies are essential in meeting these protective challenges.

Even though field agents were devoting much of their time to protection activities, they were still able to perform their criminal enforcement missions effectively. In fiscal year 1985, both arrests [1,738] and convictions [1,591] for counterfeiting exceeded the levels of fiscal year 1984. The Secret Service seized, and kept from being passed to the public, 61.7 million dollars of counterfeit notes. Efforts to suppress counterfeiting overseas have been expanded with the establishment of the Milan, Italy field office. The Secret Service is exploring the possibility of establishing additional foreign field offices.

As our society moves from financial transactions conducted primarily with paper checks and currency, to electronic, computer-based systems, the Secret Service's workload in combatting fraud involving computers, credit cards, and electronic funds transfer will continue to grow. The Secret Service is adapting its programs to meet these challenges as our financial system continues to evolve. As an example of this progress, the Secret Service has made an excellent start against the serious problem of credit card crime, with 884 arrests in fiscal year 1985. So far this fiscal year, the Service has made another 559 arrests in credit card cases.

Mr. Chairman, this concludes my opening statement. I will now ask Mr. John Simpson, The Director of the U.S. Secret Service, to provide you with his prepared statement, and we will then be pleased to respond to questions you or other members of the committee may have.

TREASURY NEWS

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FOR IMMEDIATE RELEASE

March 19, 1986

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,502 million of $21,821 million of tenders received from the public for the 2-year notes, Series X-1988, auctioned today. The notes will be issued March 31, 1986, and mature March 31, 1988.

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

	Yield	Price
Low	7.17%	99.918
High	7.21%	99.844
Average	7.19%	99.881

Tenders at the high yield were allotted 25%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 110,975	$ 41,725
New York	17,980,640	7,808,890
Philadelphia	33,300	33,300
Cleveland	71,310	68,310
Richmond	91,105	62,850
Atlanta	61,045	59,540
Chicago	1,660,145	648,895
St. Louis	121,455	105,455
Minneapolis	33,285	33,265
Kansas City	113,040	111,040
Dallas	25,320	16,570
San Francisco	1,513,135	505,885
Treasury	6,495	6,495
Totals	$21,821,250	$9,502,220

The $9,502 million of accepted tenders includes $773 million of noncompetitive tenders and $8,729 million of competitive tenders from the public.

In addition to the $9,502 million of tenders accepted in the auction process, $305 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,000 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
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MARCH 19, 1986

APPOINTMENT OF WILLIAM J. BREMNER AS DEPUTY ASSISTANT SECRETARY FOR FEDERAL FINANCE

WILLIAM J. BREMNER HAS BEEN APPOINTED DEPUTY ASSISTANT SECRETARY OF THE U.S. TREASURY FOR FEDERAL FINANCE, EFFECTIVE APRIL 1, 1986.

PREVIOUSLY, MR. BREMNER WAS VICE PRESIDENT AND A REGIONAL OFFICE MANAGER AT THE CHASE MANHATTAN TREASURY CORPORATION. BASED IN THE COMPANY'S OFFICE IN HOUSTON, TEXAS, HE WAS RESPONSIBLE FOR THE MARKETING OF U.S. TREASURY AND FEDERAL AGENCY SECURITIES, MONEY MARKET INSTRUMENTS, MUNICIPALS AND FOREIGN EXCHANGE ACTIVITIES.

FROM 1980 TO 1985, MR. BREMNER HEADED BREMNER ADVISORY CORPORATION IN LOUISVILLE, KENTUCKY, WHICH PROVIDED INVESTMENT AND FINANCIAL CONSULTING SERVICES. FROM 1969 TO 1980, MR. BREMNER WAS EMPLOYED BY THE LIBERTY NATIONAL BANK AND TRUST COMPANY IN LOUISVILLE. RISING TO SENIOR VICE PRESIDENT, HE MANAGED TAXABLE INVESTMENT PORTFOLIOS, MONEY MARKET INVESTMENTS, FEDERAL FUNDS, CERTIFICATES OF DEPOSIT, AND REPURCHASE AGREEMENTS.

MR. BREMNER SERVED IN THE UNITED STATES ARMY FROM 1966-68, INCLUDING A TOUR IN VIETNAM. HE RECEIVED A BACHELOR OF ARTS DEGREE FROM MARQUETTE UNIVERSITY IN 1965.

A FELLOW OF THE FINANCIAL ANALYSTS FEDERATION, MR. BREMNER HAS BEEN PUBLISHED IN THE AMERICAN BANKER. HE IS MARRIED AND HAS TWO SONS. HE WAS BORN ON JANUARY 19, 1943, IN CHICAGO, ILLINOIS.

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STATEMENT OF
DENNIS E. ROSS
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

The Committee is today considering the domestic and international petroleum market, and the policy implications of oil import fees. I am pleased to have this opportunity to appear before you and discuss the Treasury Department's views regarding the imposition of fees on the importation of crude oil and refined petroleum products. In particular, I will concentrate on the tax policy issues raised by various proposals to impose an excise tax or tariff on crude oil and refined petroleum products imported into the United States. Other members of the Administration will discuss the economic, energy, and foreign policy ramifications of oil import fees and the current oil market.

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 removal price during 1986 averages $18 per barrel, the revenue raised by the windfall profit tax will be negligible.

2/ Under the applicable statutory provisions, the phase-out period would begin in 1988 if the cumulative net revenues raised by the tax exceeded $227.3 billion. Under current assumptions regarding oil prices, however, the phase-out period will not 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 Pending Oil Import Fee Legislation

There are presently three bills introduced in the Senate that would in varying ways impose excise taxes or increased tariffs on imported oil and refined petroleum products. Although the Committee is not considering any specific bills, I believe it would be helpful to describe the pending legislation in full.

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 excess, if any, of a statutorily prescribed floor, set initially at $22 per barrel, over the average world price per barrel of crude oil. 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

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.

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/

The amount of the excise tax imposed under S. 1997 on each barrel of imported refined petroleum product would be equal to the per barrel excise tax on imported crude oil, increased by a $3 per barrel "environmental outlay adjustment," 6/ and 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 Btu 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 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.

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

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 gasoline 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 (5.8 Btu ÷ 5.25 Btu)	x .905
Motor fuel excise tax	$8.15

S. 1412, sponsored by Senator Hart, would increase the existing tariff on both imported crude oil and refined petroleum products by $10 per barrel. Thus, unlike S.1507 or S. 1997, the bill would not impose a higher fee on refined petroleum products than on crude oil.

S. 1412 does not by its terms exempt any types of petroleum, such as home heating fuel, from imposition of the oil import fee. Under the bill, however, the Departments of Health and Human Services and Energy would determine the monetary effect of the fee on lower-income families and individuals. An equivalent amount of the revenue raised from the import fee would be used to increase funding for Federal aid for such people. The remaining revenue for the fee would be used to reduce Social Security taxes.

<u>Discussion</u>

Although the 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 each proposal.

We face today crude oil prices that have fallen dramatically. The spot price for West Texas intermediate crude oil, for example, closed last Thursday at $12.80 per barrel. 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 are the backdrop against which the merits of increasing the fees on imported oil must be considered.

<u>Effect on Federal Revenues</u>. The potential revenue raised by the imposition of a tax on imported oil and refined petroleum products varies with the details of the particular proposal. Our analysis shows that the overall revenues (including windfall profit tax collections) raised from a fixed fee or excise tax on imported oil are not acutely sensitive to the precise level of world oil prices. Thus, a fixed per barrel excise tax on imported oil 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, would establish a fee that is explicitly dependent upon the level of world oil prices. Accordingly, the revenue raised by these proposals, unlike the fixed fee proposed by S. 1412, would be highly 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 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, however, 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, this revenue would not be realized if the current decline in world prices were reversed and prices rose again to their former levels.

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

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 $4.5 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.

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. 10/

The provisions of S. 1997 raise even greater uncertainty than those of S. 1507 in estimating likely revenue effects. Whereas the revenue raised by S. 1507 would be relatively stable so long as oil prices remained below $25 per barrel, the fee imposed and revenue raised by S. 1997 would fluctuate with increases or decreases in the price of oil. Given the volatility of oil prices and the influence of foreign governments on these prices, the taxing mechanism provided in S. 1997 would not provide a stable source of revenue over any extended period. Moreover, similar to the operation of S. 1507, S. 1997 would cease to raise revenue if the average world price of oil exceeded the adjusted reference price.

Using the same assumptions as for S. 1507 and S. 1997, we estimate that S. 1412, which would impose a flat $10 per barrel additional tariff on imported oil and refined petroleum products, would increase revenues by approximately $75.6 billion over the five-year budget period. 11/ In contrast to S. 1507 and S. 1997, which would phase out the fee if the price of oil rose above specified prices, the revenues raised by S. 1412 would be relatively stable regardless of fluctuations in oil prices.

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 home heating fuel and certain other petroleum 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.

11/ We note that the revenue raised through imposition of the oil import fee under S. 1412 would be expended to increase Federal expenditures for certain programs designed to benefit lower-income persons and to reduce Social Security taxes. In this regard, S. 1412 would not in the aggregate increase or decrease Federal revenues.

National Security Considerations. A viable domestic energy industry is integrally related to our national security. Much of the interest in an oil import fee grows out of concern over the health of that industry in a time of falling world oil prices. The recent dramatic fall in world oil prices follows a period of several years in which prices have declined on a steady basis. 12/ This downward trend in prices has already forced 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, to adjust to narrowed profit margins and a fall-off in drilling activity. If the recent and very rapid fall in world oil prices continues, the health of the domestic oil industry could be threatened, with potentially serious effects on the level of exploration and development of our domestic energy resources.

In response to the current climate of falling oil prices, several major oil companies have recently announced substantial reductions in their domestic exploration and production budgets. 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 abandoned.

Because the prices of other sources of energy are related to the price of oil, reductions in oil 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.

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 oil prices to rebound.

12/ 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.

By imposing taxes solely on imported petroleum, each of the bills described above 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 also be increased. Thus, each of the proposals would offset to some extent the effects of falling oil prices on the domestic energy industry. 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, and the consequent increase in energy costs, would have significant adverse effects on non-energy domestic businesses and industries. Most seriously affected would be 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, especially farmers, also would be hurt, since 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.

The higher energy costs that would result from an oil import fee would make it more difficult for many domestic industries to retain existing markets for their products both at home and abroad. Foreign producers of comparable goods would benefit from falling energy costs, while U.S. energy prices would remain at a relatively higher level because of the oil import fee. 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.

The effects described above would have a negative impact on our balance of trade, which could more than offset the positive trade effects of reduced imports of foreign crude oil and refined products that would result from imposition of an import fee. Thus, the net effect of an oil import fee could be to worsen our balance of trade position.

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 such relief would be effective in only a limited number of cases, and that the international competitiveness of many industries would still be negatively affected. Although the exemption would benefit vertically integrated producers that directly import petroleum for use in the manufacture of exports, it would be of limited use, 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 that an oil import fee would likely entail.

Although the effects of an oil import fee on domestic industry would in general be negative, am import fee would aid certain sectors of the domestic energy industry, including 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. 13/ Although domestic refiners, like all purchasers of oil, would face the higher energy costs resulting from an oil import fee, they would benefit to the extent a higher fee is imposed on refined products than on crude oil, and a disincentive thus established for 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 on banks with significant energy loan portfolios. Many such banks have recently made provisions for additional loss reserves and have reduced their volume of new energy loans. Continued instability in oil prices may have more serious effects on such banks, and could trigger some failures. By softening the fall of domestic energy prices, an oil import fee would protect those banks from declines in market prices. On the other hand, imposition of an oil import fee could hurt banks with loans to oil-exporting countries, since the fee could affect the oil revenues flowing to such countries.

13/ 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.

<u>**Effects on Energy Consumption**</u>. Higher energy costs have encouraged greater energy conservation, and thus such developments as more fuel-efficient cars and appliances, and the design and installation of more energy-efficient industrial facilities. While these developments may represent more or less 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.

<u>**Effect on Consumers**</u>. 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 for 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 result from 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. 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.

<u>Distributional Impact</u>. 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 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 items. 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 reduced, 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. The impact of S. 1997, as illustrated in Table 1, is also regressive. Although we have not had an opportunity to prepare a distributional analysis of S. 1412, its distributional impact, ignoring the increased transfer payments and reduced Social Security taxes provided by the bill, would be similar to the other bills. We note, however, that the increased transfer payments and reduced Social Security taxes contemplated by S. 1412 would mitigate its regressive effect.

There are a number of ways to reduce the regressive nature of a tax on imported oil and refined products in addition to the exemptions for home heating fuel, the increased Federal appropriations, or the reduction in Social Security taxes proposed by the three 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. 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 have insufficient income to generate a tax liability.

Second, consideration could be given to targeting relief narrowly to lower income families. In particular, imposition of an oil import fee could be accompanied by enactment of a refundable income tax credit for lower income families. Although a refundable credit might be difficult to design satisfactorily and would undoubtedly pose substantial administrative problems, such a credit would 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 2, 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 2, the burden of an oil import fee, if imposed without any exception, would be felt most heavily in the Northeast. Both S. 1507 and S. 1997 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. 14/ This solution, while in concept well-intentioned, raises several concerns.

Exemptions for petroleum used for specific purposes are difficult to administer, will impose bureaucratic burdens on segments of the domestic oil industry, and may offer only limited relief to the affected persons. For example, if an exemption were granted only for 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,

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14/ Under S. 1412, the reduction in Social Security taxes resulting from the oil import fee revenues remaining after the increases in Federal funding for certain lower-income programs would be allocated among the States in proportion to the monetary effect of the increased tariff on residents of each State. This provision, which would mitigate the disparate regional impact of an oil import fee, would apparently require the imposition of different Social Security tax rates in various States.

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, reduces 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, which would not enjoy any special exemptions. 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, also would fall disproportionately on the Northeast. Similarly, natural gas prices would increase commensurately with higher oil prices. The increased cost of heating homes with electricity or natural gas, however, is not addressed in either S. 1507 or S. 1997. In addition, California would be especially affected by an oil import fee, because of its dependence upon oil-generated electricity. A scheme of exemptions for residual fuel designed to offset 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.

<u>Foreign Policy Considerations</u>. 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 (the "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. 15/

Administrative Burdens. As noted above, we are concerned that the proposals for various exemptions contained in S. 1507 and S. 1997 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.

Effect of GATT and Other Treaty Issues. We are continuing to study whether the various oil import fee proposals are consistent with our treaty obligations under the GATT and various other bilateral agreements. We have committed ourselves in the GATT not to increase our tariffs on refined petroleum products. 16/ Each of the oil import fees described above 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 could 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.

15/ Based on existing import levels, if an exemption were provided for crude oil and refined petroleum products imported from Mexico, we currently estimate a 13 percent reduction in the revenue potentially raised by S. 1997. If exemptions were provided for Canada, Venezuela, or the United Kingdom, we estimate that the revenue would be decreased by 11 percent, 9 percent, and six percent, respectively. Somewhat greater reductions would arise under S. 1507 or S. 1412. 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.

16/ 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.

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 could also reduce the net revenue raised from any oil import fee.

If the import fee were applied on a discriminatory basis, by exempting oil imported from certain countries, it also would violate the non-discrimination obligation in the GATT generally known as the most favored nation provision. Moreover, 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 countries from any oil import fee would be likely to draw a response from those countries entitled to most favored nation treatment that are not excepted.

Macroeconomic Effects. 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. 17/ 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.

17/ 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.

Conclusion

As I have indicated throughout my testimony, there are both advantages and disadvantages to the imposition of an oil import fee as proposed in S. 1412, S. 1507 and S. 1997. Previously, the Administration had considered whether an oil import fee might appropriately be included as part of a revenue neutral tax reform proposal. After additional study, the Administration has concluded that, on balance, the costs of an oil import fee outweigh the benefits. Accordingly, the Administration is opposed to the imposition of a fee on the importation of crude oil or refined petroleum products.

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/ Electricity	Fuel Oil&LPG	Gasoline	Total	Increase in Expenditures as Percent of Family Income 2/ 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		

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/ Electricity	Fuel Oil&LPG	Gasoline	Total	Increase in Expenditures as Percent of Family Income 2/ 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		

Office of the Secretary of the Treasury
Office of Tax Analysis

March 21, 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

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

March 24, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,801 million of 13-week bills and for $6,815 million of 26-week bills, both to be issued on March 27, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 26, 1986			26-week bills maturing September 25, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	6.33%	6.52%	98.400	6.42%	6.73%	96.754
High	6.38%	6.58%	98.387	6.44%	6.75%	96.744
Average	6.36%	6.56%	98.392	6.43%	6.74%	96.749

Tenders at the high discount rate for the 13-week bills were allotted 22%.
Tenders at the high discount rate for the 26-week bills were allotted 93%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 38,470	$ 38,470	$ 33,575	$ 33,575
New York	18,619,805	5,583,605	19,154,600	5,112,400
Philadelphia	23,075	23,075	18,175	18,175
Cleveland	40,470	40,470	23,740	23,740
Richmond	43,655	43,655	30,785	30,785
Atlanta	41,545	41,545	38,895	28,790
Chicago	1,392,880	344,880	1,855,025	720,835
St. Louis	77,985	50,425	70,400	42,400
Minneapolis	16,880	16,880	13,755	13,755
Kansas City	52,700	52,700	42,500	42,500
Dallas	48,100	44,200	28,705	18,705
San Francisco	1,168,860	251,860	1,218,520	354,950
Treasury	269,080	269,080	373,925	373,925
TOTALS	$21,833,505	$6,800,845	$22,902,600	$6,814,535
Type				
Competitive	$19,151,080	$4,118,420	$19,497,290	$3,409,225
Noncompetitive	974,560	974,560	891,525	891,525
Subtotal, Public	$20,125,640	$5,092,980	$20,388,815	$4,300,750
Federal Reserve	1,474,350	1,474,350	1,450,000	1,450,000
Foreign Official Institutions	233,515	233,515	1,063,785	1,063,785
TOTALS	$21,833,505	$6,800,845	$22,902,600	$6,814,535

An additional $985 thousand of 13-week bills and an additional $4,015 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. March 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 $ 14,000 million, to be issued April 3, 1986. This offering will result in a paydown for the Treasury of about $ 450 million, as the maturing bills are outstanding in the amount of $14,447 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 31, 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 January 2, 1986, and to mature July 3, 1986 (CUSIP No. 912794 KV 5), currently outstanding in the amount of $7,628 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $7,000 million, representing an additional amount of bills dated October 3, 1985, and to mature October 2, 1986 (CUSIP No. 912794 KR 4), currently outstanding in the amount of $8,421 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 April 3, 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 $ 779 million as agents for foreign and international monetary authorities, and $3,259 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 March 25, 1986

RESULTS OF AUCTION OF 4-YEAR NOTES

The Department of the Treasury has accepted $7,040 million of $26,754 million of tenders received from the public for the 4-year notes, Series N-1990, auctioned today. The notes will be issued March 31, 1986, and mature March 31, 1990.

The interest rate on the notes will be 7-1/4%. The range of accepted competitive bids, and the corresponding prices at the 7-1/4% interest rate are as follows:

	Yield	Price
Low	7.29%	99.863
High	7.29%	99.863
Average	7.29%	99.863

Tenders at the high yield were allotted 75%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 42,139	$ 9,139
New York	23,523,498	6,684,988
Philadelphia	7,720	7,720
Cleveland	107,061	19,061
Richmond	62,526	13,526
Atlanta	26,931	16,931
Chicago	1,739,863	150,863
St. Louis	82,954	72,954
Minneapolis	4,438	4,438
Kansas City	42,192	41,192
Dallas	8,999	2,999
San Francisco	1,104,385	15,385
Treasury	800	800
Totals	$26,753,506	$7,039,996

The $7,040 million of accepted tenders includes $447 million of noncompetitive tenders and $6,593 million of competitive tenders from the public.

In addition to the $7,040 million of tenders accepted in the auction process, $465 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $458 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-518

03626

TREASURY NEWS

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

March 26, 1986

Charles H. Powers Appointed
Deputy Assistant Secretary (Public Affairs)

The Treasury Department today announced the appointment of Charles H. Powers as Deputy Assistant Secretary (Public Affairs), effective March 17, 1986. Mr. Powers will report directly to Margaret D. Tutwiler, Assistant Secretary (Public Affairs and Public Liaison).

The Office of Public Affairs, which Mr. Powers will manage, maintains liaison with the news media, coordinates the public activities of Treasury Department officials, and produces public information materials.

Mr. Powers rejoined the Treasury Public Affairs staff in late 1985 after an association with Ogilvy and Mather Washington. He had previously served the Treasury Department from 1975 to 1978 and from 1980 to 1985.

He served as a public affairs officer with the Internal Revenue Service in Philadelphia and Washington, D.C. In 1982 he became a public affairs officer in the Office of the Secretary.

Mr. Powers was press secretary to U.S. Senator Richard S. Schweiker of Pennsylvania from 1978 to 1980.

His active duty U.S. Air Force service included assignment in Southeast Asia in 1969. He is currently a member of the Air Force Reserve. He also worked in television news at WTJV-TV, Miami, Florida, and WMAL-TV, Washington, D.C.

Mr. Powers received his AB degree from the University of Miami (1965) and MA degree from New York University (1967). He resides in Alexandria, Virginia with his wife and two sons. Mr. Powers was born May 7, 1945 in New York City.

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B-519

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

FOR IMMEDIATE RELEASE

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DEPARTMENT OF THE TREASURY

March 26, 1986

RESULTS OF AUCTION OF 7-YEAR NOTES

The Department of the Treasury has accepted $ 6,505 million of $ 15,996 million of tenders received from the public for the 7-year notes, Series F-1993, auctioned today. The notes will be issued April 3, 1986, and mature April 15, 1993.

The interest rate on the notes will be 7-3/8%. The range of accepted competitive bids, and the corresponding prices at the 7-3/8% interest rate are as follows:

	Yield	Price
Low	7.44%	99.640
High	7.50%	99.318
Average	7.48%	99.425

Tenders at the high yield were allotted 59%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 23,432	$ 3,432
New York	13,762,745	5,272,093
Philadelphia	773	773
Cleveland	172,995	150,445
Richmond	17,629	8,809
Atlanta	10,888	7,888
Chicago	1,398,904	940,044
St. Louis	42,118	26,118
Minneapolis	6,750	6,750
Kansas City	15,298	15,298
Dallas	7,875	6,645
San Francisco	535,822	66,702
Treasury	385	385
Totals	$15,995,614	$6,505,382

The $ 6,505 million of accepted tenders includes $ 314 million of noncompetitive tenders and $ 6,191 million of competitive tenders from the public.

B-520

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

FOR RELEASE AT 4:00 P.M. March 27, 1986

TREASURY OFFERS $15,000 MILLION OF 14-DAY CASH MANAGEMENT BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $15,000 million of 14-day Treasury bills to be issued April 3, 1986, representing an additional amount of bills dated April 18, 1985, maturing April 17, 1986 (CUSIP No. 912794 KB 9).

Competitive tenders will be received at all Federal Reserve Banks and Branches prior to 1:00 p.m., Eastern Standard time, Tuesday, April 1, 1986. Each tender for the issue must be for a minimum amount of $1,000,000. Tenders over $1,000,000 must be in multiples of $1,000,000. Tenders must show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions must not be used.

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

The bills will be issued on a discount basis under competitive bidding, and at maturity their par amount will be payable without interest. The bills will be issued entirely in book-entry form in a minimum denomination of $10,000 and in any higher $5,000 multiple, on the records of the Federal Reserve Banks and Branches. Additional amounts of the bills may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of 12:30 p.m., Eastern time, on the day of the auction. Such positions would include bills acquired through "when issued" trading, futures, and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering, e.g., bills with three months to maturity previously offered as six-month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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

Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. 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. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch in cash or other immediately-available funds on Thursday, April 3, 1986. 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, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars may be obtained from any Federal Reserve Bank or Branch.

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

FOR IMMEDIATE RELEASE
MARCH 27, 1986

Contact: Bob Levine
(202)566-2041

BAKER WELCOMES NEW IMF FACILITY FOR LOW INCOME COUNTRIES

Secretary of the Treasury James A. Baker, III today welcomed the IMF Executive Board decision to create a new facility, the Structural Adjustment Facility, to support comprehensive growth-oriented economic programs in low-income countries with protracted balance of payments problems. The funds in this Facility will be complemented by World Bank and other resources to facilitate economic growth in these countries, most of which are in Sub-Saharan Africa. The resources are to be used in the context of a comprehensive macroeconomic and structural policy framework to be developed by the IMF, the World Bank and each member country. The Secretary regards this as a major step in strengthening the cooperation of the IMF and World Bank in support of comprehensive economic programs by these countries. The World Bank Board also supported the U.S. approach in its March 17 meeting.

The support of the two Boards reflects extensive international consultations toward implementation of a proposal to assist the lowest-income countries put forward by Secretary Baker at the IMF/IBRD Annual Meetings in Seoul this past October. Secretary Baker expressed appreciation for the efforts of many industrial and developing countries in shaping the final proposal in order to attract broad international support, and to the managements of the IMF and World Bank for their constructive contributions to this cooperative effort.

The Secretary believes the approach can serve as an important catalyst to encourage additional flows for comprehensive economic policy reform, thus providing a useful framework for multilateral support of economic growth in the lowest-income countries.

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B-522

TREASURY NEWS

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

<u>For Immediate Release</u>
March 28, 1986

Contact: Charlie Powers
566-5252

TREASURY DEPARTMENT ASSESSES PENALTY AGAINST
BARNETT BANKS OF FLORIDA, INC. UNDER BANK SECRECY ACT

The Department of the Treasury announced today that Barnett Banks of Florida, Inc., a bank holding company headquartered in Jacksonville, Florida, has agreed to a settlement that requires the bank to pay a civil penalty of $112,000 for failure to report 513 currency transactions as required by the Bank Secrecy Act.

David D. Queen, Acting Assistant Secretary (Enforcement and Operations), who announced the penalty, said the penalty represented a complete settlement of Barnett's Banks civil liability for these violations. Queen said Barnett Banks promptly and on its own initiative brought this matter to the attention of the Department of the Treasury, cooperated fully with Treasury, and conducted a complete internal investigation of its Bank Secrecy Act compliance. Barnett Banks has enhanced its existing compliance program to ensure full compliance by all its banks with reporting requirements in the future.

The Department of the Treasury has no evidence that Barnett Banks engaged in any criminal activities in connection with these reporting violations.

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B-523

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

FOR IMMEDIATE RELEASE March 31, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,025 million of 13-week bills and for $7,002 million of 26-week bills, both to be issued on April 3, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 3, 1986			:	26-week bills maturing October 2, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	6.32%	6.51%	98.402	:	6.30% a/	6.60%	96.815
High	6.36%	6.56%	98.392	:	6.33%	6.63%	96.800
Average	6.35%	6.54%	98.395	:	6.32%	6.62%	96.805

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

Tenders at the high discount rate for the 13-week bills were allotted 19%.
Tenders at the high discount rate for the 26-week bills were allotted 77%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 39,580	$ 39,580	:	$ 31,170	$ 31,170
New York	22,945,910	6,160,055	:	16,695,730	5,804,530
Philadelphia	28,830	28,830	:	14,795	14,795
Cleveland	44,720	44,720	:	24,835	24,835
Richmond	41,295	41,295	:	44,775	44,775
Atlanta	38,475	38,475	:	35,640	35,640
Chicago	1,631,380	95,330	:	1,471,035	347,035
St. Louis	71,390	51,390	:	72,455	46,455
Minneapolis	16,085	16,085	:	13,270	13,270
Kansas City	49,915	49,510	:	39,000	39,000
Dallas	42,855	33,805	:	26,790	21,790
San Francisco	1,427,380	120,570	:	1,308,135	190,635
Treasury	305,410	305,410	:	388,305	388,305
TOTALS	$26,683,225	$7,025,055	:	$20,165,935	$7,002,235
Type					
Competitive	$23,691,640	$4,033,470	:	$17,258,045	$4,094,345
Noncompetitive	1,039,175	1,039,175	:	898,490	898,490
Subtotal, Public	$24,730,815	$5,072,645	:	$18,156,535	$4,992,835
Federal Reserve	1,796,710	1,796,710	:	1,500,000	1,500,000
Foreign Official Institutions	155,700	155,700	:	509,400	509,400
TOTALS	$26,683,225	$7,025,055	:	$20,165,935	$7,002,235

1/ Equivalent coupon-issue yield.

B-524

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
April 1, 1986

CONTACT: Art Siddon
566-5252

TREASURY PLANS PILOT PROGRAM FOR DEAF

The Department of the Treasury announced today that it will begin in mid-summer a government-wide pilot test to improve accessability of federal agencies and information to the deaf, hearing impaired and speech impaired.

The one-year pilot test, undertaken in cooperation with the U.S. Architectural and Transportation Barriers Compliance Board (ATBCB), will allow the Treasury and the ATBCB to assess jointly the level of interest among federal agencies and the feasibility of supporting the program beyond the trial period.

Under the program, two modern Telecommunications Devices for the Deaf (TDD) will be collocated with Treasury telephone operations in the Office of the Secretary's Telecommunications Center in the Main Treasury Building.

Once the TDD units are installed, a TDD user in any of the 50 states, Puerto Rico or the Virgin Islands wishing to contact an agency of the Executive, Legislative or Judicial branches may call the Treasury TDD relay. A government office wishing to contact an individual with a TDD will be able to call the Treasury TDD operator, as well.

The TDD relay operator will answer the call, receive the message from the TDD user, and acknowledge the message through the TDD relay. The operator will then telephone the called party, announce that "Treasury TDD operator" is calling on behalf of "name and other identification of the TDD user" and relay the message or request for information. The operator will continue to relay messages -- via the TDD in one direction and orally in the other direction -- until the conversation has ended.

It is anticipated that the TDD relay will operate from 9:00 a.m. to 5:00 p.m. (Eastern Time), Monday through Friday except on federal holidays.

# # #

B-525

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

FOR RELEASE AT 4:00 P.M.

April 1, 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 April 10, 1986. This offering will result in a paydown for the Treasury of about $450 million, as the maturing bills are outstanding in the amount of $14,451 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, April 7, 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 July 11, 1985, and to mature July 10, 1986 (CUSIP No. 912794 KN 3), currently outstanding in the amount of $15,971 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,000 million, to be dated April 10, 1986, and to mature October 9, 1986 (CUSIP No. 912794 LF 9).

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 April 10, 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 $676 million as agents for foreign and international monetary authorities, and $3,297 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 April 1, 1986

RESULTS OF TREASURY'S AUCTION OF 14-DAY CASH MANAGEMENT BILLS

Tenders for $15,030 million of 14-day Treasury bills to be issued on April 3, 1986, and to mature April 17, 1986, were accepted at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low	7.18%	7.29%	99.721
High	7.24%	7.37%	99.718
Average	7.22%	7.35%	99.719

Tenders at the high discount rate were allotted 47%.

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

Location	Received	Accepted
Boston	$ --	$ --
New York	55,614,000	14,350,750
Philadelphia	--	--
Cleveland	--	--
Richmond	40,000	--
Atlanta	--	--
Chicago	4,016,500	491,570
St. Louis	--	--
Minneapolis	625,000	--
Kansas City	30,000	--
Dallas	--	--
San Francisco	2,475,000	188,000
TOTALS	$62,800,500	$15,030,320

B-527

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

BIOGRAPHICAL NOTES

CHARLES SCHOTTA
DEPUTY ASSISTANT SECRETARY
FOR ARABIAN PENINSULA AFFAIRS

Charles Schotta is Treasury Deputy Assistant Secretary for Arabian Peninsula Affairs. He is responsible for the formulation and execution of Treasury Department policy on international energy issues and toward the countries of the Arabian Peninsula, particularly Saudi Arabia. The U.S.-Saudi Arabian Joint Commission on Economic Cooperation is under his direction. He also directs collection of data on U.S. bank and corporate claims on and liabilities to foreign entities.

From 1979 to 1983, Mr. Schotta was Deputy Assistant Secretary for Commodities and Natural Resources. He joined the Treasury in 1971 as Chief of the Econometrics Group in the Office of the Assistant Secretary for International Affairs. From 1973 to 1975, he was director of the Office of International Financial Analysis; from 1975 to 1977, he was Director of the Office of Energy Policy Analysis; and from 1977 to 1979, he was Director of the Office of International Energy Policy.

Prior to joining the Treasury Department, Mr. Schotta was Associate Professor of Economics at Virginia Tech. He also served on the faculties of the University of California, Davis, the University of Texas, El Paso, and Texas Christian University. In addition to authoring numerous articles on a wide range of economic and financial subjects, he has consulted widely in the banking, public utility, insurance, and anti-trust fields for both business and government.

Mr. Schotta holds a B.A. degree in Economics from Texas Christian University and an M.A. degree in Economics from Brown University, where he also pursued additional graduate studies.

Mr. Schotta hails from Fort Worth, Texas.

B-528
(Rev.)

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

FOR RELEASE AT 12:00 NOON

April 4, 1986

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $9,250 million of 364-day Treasury bills to be dated April 17, 1986, and to mature April 16, 1987 (CUSIP No. 912794 MF 8). This issue will provide about $900 million of new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $8,362 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, April 10, 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 April 17, 1986. In addition to the maturing 52-week bills, there are $14,550 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 $1,687 million as agents for foreign and international monetary authorities, and $5,360 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.

B-529

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 FRANCIS A. KEATING, II
ASSISTANT SECRETARY (ENFORCEMENT)
U.S. DEPARTMENT OF THE TREASURY
AT THE
LAWYERS' COMMITTEE MEETING
ASSOCIATION OF BANK HOLDING COMPANIES

April 3, 1986

Treasury's Enforcement and Administration of the Bank Secrecy Act

I want to thank the Association for the opportunity to take part in the Lawyer's Committee Program. As many of you know, I am new to the job of Assistant Secretary. I have been involved with the Bank Secrecy Act for only a very brief time, and only from a broad, policy perspective.

Nevertheless, I would like to share with you my thoughts on Treasury's administration of the Act, from the standpoint of financial institutions generally and bank holding companies in particular. I will first discuss why Treasury places such emphasis on compliance with the reporting requirements under the Act and the regulations. Then, I will say a few words about our enforcement policy.

First, as to the reporting, we must not lose sight of the need for the information itself. This information is indispensable to our financial investigations. Recently, you have heard much about money laundering, and money laundering remains a serious challenge -- not only to law enforcement, but also to the financial community, and to the public at large.

But money laundering is not the only problem the Bank Secrecy Act was intended to address. The report information also assists law enforcement in combatting drug trafficking, tax evasion, and organized crime. The investigations that rely on the information are not Treasury's alone. Other federal agencies and even state and local law enforcement use this information to uncover and attack the financial base of criminal enterprises.

Some of the most important uses of the information pertain to the thirteen task forces that President Reagan created to investigate organized crime and drug trafficking. Since becoming fully operational in July of 1983, these task forces have initiated over 1200 cases. They have resulted in the indictment of 8500 individuals and 3400 convictions.

These statistics are only part of the story. Two out of every three of those cases have a financial component, and an even larger percentage use Treasury's financial analytical capability in one way or another. This analytical capability, as you know, is wholly dependent on the Bank Secrecy Act reporting information. This information, when analyzed, can provide direct leads for new investigations. It can provide support for ongoing investigations. And even where a specific investigation is not involved, the information allows us to track currency flows and detect abnormal patterns that could be an indication of illicit financial activity. This information may reflect the need for international law enforcement cooperation.

We must remember that money is the lifeblood of organized crime. To the extent that we can detect illicit financial activity, we can strike a blow against the criminal enterprises that victimize our society.

But to return to the specific problem of money laundering: the reporting is a means to a larger end. Our overall goal is to deny the money launderer his access to our financial system. This is, admittedly, an ambitious undertaking, but it is one that we are firmly committed to achieving.

Law enforcement alone cannot attain this goal. We must have the participation and support of the financial community. From the inception of the Act, Treasury, in accordance with the legislative intent, has relied upon the financial community, and especially banks, to support our efforts.

No bank can do its part against money laundering unless it has a comprehensive program to ensure compliance. It should be clear to all of us by now that money launderers look for banks that are lax when it comes to currency transaction reports. And exempt list status is something that criminal organizations value highly. No bank should take the reporting obligations lightly: to do so is to risk not only coming under the sanctions of the Bank Secrecy Act, but also becoming the prey of the money launderer and his criminal cohorts.

There is another reason why compliance is essential for a bank. A bank's reputation is among its most valued assets. There is a danger of harm to this reputation whenever a bank is associated in the public's mind with organized crime. It is only prudent for a bank to take steps to keep the money launderer from making it an unwitting accomplice.

Compliance is not solely a matter for tellers and branch managers. It must be a commitment, expressed and emphasized by top management. The bank must be able to conduct its own internal audits to see that reporting is comprehensive and timely. Exempt lists, which have posed a problem for some banks, should receive close scrutiny as a matter of policy.

As far as training is concerned, employees should know how to recognize the commonly-used methods of the money launderer, such as repeated cash transactions under $10,000, or the purchasing of cashier's checks with cash by non-customers. The latter, as you may know, is the modus operandi of the so-called "smurf", who goes from bank to bank exchanging cash crime proceeds for a more readily transportable and less suspicious form of funds.

The guiding principle here is a simple one: a bank should take reasonable steps to know its customers. And the bank's employees should be prepared to notify the Internal Revenue Service when they notice suspicious financial activity, such as the "smurfing" I just mentioned.

Compliance, as we all know, is a legal obligation. But beyond legal obligations, there is an ethical obligation as well. Just as we are all obliged to be good citizens, part of this obligation is doing our part to prevent crime and to report crimes that we witness. This obligation does not stop at the doors of a financial institution. Treasury urges every bank to take affirmative steps to guard against money laundering, and we will continue to work with the financial community toward this end.

We have met with organizations in your industry, such as the American Bankers Association, and we have lent our participation and support to programs to educate financial institutions on the need for programs to ensure compliance and to provide for the training of bank employees. We are also exploring avenues to work more closely with the industry on such matters as revision of the Bank Secrecy Act regulations.

Penalty Assessment

I would now like to move on to the matter of enforcement policy. As you are probably aware, Treasury since last June has announced 14 civil penalties against banks and bank holding companies. We anticipate that many more will be announced over the next several months. In the four cases with holding companies, we have allowed the bank holding companies to negotiate and settle on behalf of their subsidiary banks. We have generally given holding companies the option whether to announce the settlement as an assessment of separate penalties against the banks or as a settlement against the holding company on behalf of its banks.

We have also determined not to assess penalties in several cases. When such a determination is made, a letter is sent to the bank or holding company, as appropriate. We make no public announcement of the decision not to impose a penalty.

We believe that rigorous enforcement, including the imposition of penalties, is essential to increased awareness of the Bank Secrecy Act and to improved compliance. For example, in response to our enforcement policies, all the banks with which we have been meeting have vastly improved their overall compliance programs - training, legal review, audit procedures, exemption review.

Penalty Factors

In assessing a penalty, we consider many factors -- the nature and volume of violations, the effectiveness of the bank's past Bank Secrecy Act compliance program and controls, the circumstances of disclosure, the degree of cooperation, the bank's commitment to future compliance, the size of the bank, and to some extent, the financial condition of the bank.

In assessing the penalties, we have tried to be as evenhanded as possible without being rigid. We consider it our duty to those who have settled with us already to treat similarly situated banks in a similar manner.

What To Do If Violations Are Discovered

If you discover violations or receive a critical examination from a bank regulatory agency, you should contact my office. We will then give you guidance on what further information will be required and what further late-filing of CTR's must be done. Our policy in such cases is to request an extensive memorandum explaining how and why the violations occurred. In this way, we can begin our dialogue with you and prepare to consider the many factors present in an individual case.

All late-filed CTR's should be filed in the usual way with the Internal Revenue Service with copies provided to my office. Late-filing with the IRS alone, without notice to my office, will only delay bringing the matter to our attention -- it will not bury the matter. We have the capability and are currently searching late-filings to ascertain whether banks have been late-filing CTRs without notifying Treasury.

We will be especially concerned about the scope of your review of non-compliance. Before we reach a settlement, we want to have some reasonable assurance that the non-compliance a bank has disclosed to us is the full extent of the problem.

We will routinely request a waiver of the civil statute of limitations. Our experience is that assembling the required information and late-filing may take several months, or in any event longer than it might appear at first.

Treasury will request late-filing of CTR's with respect to a number of types of unreported transactions. For example, in all cases in which a bank has failed to file transactions with a foreign correspondent bank, or with a domestic foreign currency dealer, we will require complete late-filing for five years. There is a very high degree of law enforcement utility for this information. We believe that there is a continuing legal duty to late-file.

We will not require late-filing of every unreported transaction stemming from an improper exemption. Therefore, we encourage you to disclose violations to Treasury early, before you undertake extensive late-filing. In the area of exempt list violations, we may be able to work together to lessen the late-filing burden.

When we receive the requested written information, we will then invite you in for a meeting or a series of meetings with one of our attorneys from the Treasury Office of General Counsel and a member of my staff. If settlement is reached, a standard written agreement wherein the bank denies liability, but agrees to payment of a penalty, will be signed by both parties.

I want to reassure you on an important point: the fact that a bank is negotiating with Treasury is closely held. If there is a press inquiry, Treasury will neither confirm nor deny that it is talking to a bank.

If settlement cannot be reached, we will refer the matter to the Department of Justice for civil action. We want to reach an amicable settlement with all banks that come forward voluntarily with past non-compliance. We do not believe it would serve the best interest of either party to become embroiled in a litigation battle. We do not intend to test legal questions by litigation as the course of first resort. Nor will we be reluctant to litigate, if given no choice.

The Question of Publicity

This brings us to the matter that I know is of special concern to you -- the way in which Treasury treats the public announcement of penalties. Treasury has become very sensitive to banks' apprehension regarding public announcements of penalties. Since I came to Treasury, it is fair to say I have made no efforts to maximize press attention to the penalties that have been announced. Nevertheless, I believe that some public announcement is essential to our compliance effort. For this reason, and in fairness to those banks who have already settled with us, I intend to announce every penalty by press release. I do not intend generally to hold press conferences when penalties are announced.

The press release will note, where appropriate, the cooperation of the bank and that Treasury has no information that the bank was engaged in criminal activities in connection with the violations. We make the settlement agreement available to the press on request, and if the information is readily available, we also inform the press of the unreported dollar amount underlying the violations.

While we will not allow banks to prescreen our press releases, we will consider including in the release points that a bank suggests, and we will coordinate with the bank on the timing of a release. In settlements with holding companies on behalf of their subsidiaries, we will decide on a case-by-case basis whether to announce the names of the individual banks.

Treasury does not dictate to a bank on the way it handles the announcement of the penalty. We only caution that the bank be truthful and responsible and not make light of the matter by dismissing the violations as "technical."

We envision that the matter will be in and out of the news in one day. We are not interested in engaging you in prolonged public debate.

Advantage of Voluntary Disclosure

Some of you may be asking yourselves a fundamental question: Why should a bank come forward voluntarily?

There is no question that Treasury will look more favorably on a bank that voluntarily discloses past violations. A bank that discovers past violations and fails to disclose them to Treasury runs a calculated risk, especially in light of improved examination procedures by bank regulators. In our view, the character of the case of such a bank changes significantly when the decision to take this risk becomes apparent.

And finally, I want to add that we have not closed the doors to volunteers, and we encourage you and your clients to come forward.

Relationship of Civil to Criminal Cases

I will now turn to a topic about which many banks have raised questions--the relationship of criminal cases to civil cases.

Treasury routinely refers cases of serious non-compliance to the Internal Revenue Service's Criminal Investigations Division for evaluation. The IRS then decides whether to refer the case to the Department of Justice for criminal action. The settlement agreements specifically state that civil settlement does not in any way restrict criminal investigation and referral. We cannot and will not make any accommodation on criminal treatment in civil settlement negotiations.

Under the statutory scheme, criminal and civil penalties are cumulative. In cases where there has been a criminal connection, Treasury will follow with civil penalties, where appropriate, and conversely, criminal sanctions may follow civil penalties.

If there is an ongoing criminal case, we will defer resolution of the civil case if requested to do so by the United States Attorney handling the case. We ask the bank for a waiver of the statute of limitations, and we resume discussions at the conclusion of the criminal case or when we are given the go ahead by the United States Attorney.

In concluding my remarks today, let me express, once again, my appreciation for the opportunity to meet with you and to discuss topics in which Treasury, as well as all of you, have a substantial interest.

Thank you for your kind attention, and I look forward to hearing your questions and comments.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE

April 7, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,015 million of 13-week bills and for $7,016 million of 26-week bills, both to be issued on April 10, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 10, 1986			26-week bills maturing October 9, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	6.16%	6.34%	98.443	6.15%a/	6.44%	96.891
High	6.20%	6.39%	98.433	6.18%	6.47%	96.876
Average	6.19%	6.38%	98.435	6.17%	6.46%	96.881

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

Tenders at the high discount rate for the 13-week bills were allotted 56%.
Tenders at the high discount rate for the 26-week bills were allotted 49%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 46,735	$ 44,235	$ 32,940	$ 32,940
New York	21,047,820	5,889,530	18,078,620	5,624,060
Philadelphia	23,485	23,485	13,880	13,880
Cleveland	50,435	50,435	28,650	28,650
Richmond	48,905	46,985	27,775	27,775
Atlanta	53,250	46,250	71,355	41,705
Chicago	1,719,875	291,915	1,525,150	369,970
St. Louis	70,125	42,125	71,420	44,400
Minneapolis	16,920	16,620	15,890	11,890
Kansas City	50,410	50,410	44,360	44,360
Dallas	44,880	34,880	31,600	26,600
San Francisco	1,768,720	109,280	1,331,890	301,890
Treasury	368,770	368,770	447,885	447,885
TOTALS	$25,310,330	$7,014,920	$21,721,415	$7,016,005
Type				
Competitive	$22,287,980	$3,992,570	$18,768,000	$4,062,590
Noncompetitive	1,205,815	1,205,815	957,115	957,115
Subtotal, Public	$23,493,795	$5,198,385	$19,725,115	$5,019,705
Federal Reserve	1,671,535	1,671,535	1,625,000	1,625,000
Foreign Official Institutions	145,000	145,000	371,300	371,300
TOTALS	$25,310,330	$7,014,920	$21,721,415	$7,016,005

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. ROOM 5310 April 8, 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 April 17, 1986. This offering will result in a paydown for the Treasury of about $550 million, as the maturing bills are outstanding in the amount of $14,550 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, April 14, 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 January 16, 1986, and to mature July 17, 1986 (CUSIP No. 912794 KW 3), currently outstanding in the amount of $7,660 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,000 million, to be dated April 17, 1986, and to mature October 16, 1986 (CUSIP No. 912794 LG 7).

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 April 17, 1986. In addition to the maturing 13-week and 26-week bills, there are $8,362 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 $2,132 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $2,257 million as agents for foreign and international monetary authorities, and $5,510 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
epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE April 8, 1986

AMENDED WEEKLY BILL OFFERING

The weekly bill offering announcement made earlier today understated the amount to be paid down by the Treasury Department. The bills maturing April 17, 1986, total $29,580 million (including the 14-day cash management bills issued April 3, 1986, in the amount of $15,030 million). Accordingly, the amount to be paid down should have been shown as $15,575 million rather than $550 million.

All other particulars in the announcement remain the same.

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B-535

TREASURY NEWS

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

Statement by
Robert A. Cornell
Deputy Assistant Secretary
for Trade and Investment Policy
Department of the Treasury

Before
Subcommittees on Africa and
International Economic Policy and Trade
Committee on Foreign Affairs
House of Representatives

April 9, 1986

Chairmen and Members of the Subcommittees:

I appreciate the opportunity to present the Treasury Department's views on H.R. 997 and to comment on the sanctions approach contained therein. The Administration, like the Congress, seeks the end of apartheid and establishment of a system of government in South Africa in which all South Africans can participate.

Assistant Secretary Crocker has outlined implementation of the President's September 1985 Executive Order, and has put forth our position on further sanctions on South Africa. Two significant economic elements in the September package were the ban on importation of Krugerrands and the ban on bank lending to the South African Government and its instrumentalities. These two measures which are enforced by Treasury were designed to send strong signals to the South African Government rather than to damage the economic well-being of the South African people. Treasury has strictly enforced these two measures and is not aware of any efforts to evade either.

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We think that measures such as those proposed in H.R. 997, aimed at the entire South African economy, will not realize their goal, even though they may be sincerely intended to do so. We hold this view for several reasons:

-- Eliminating the U.S. economic presence in South Africa and attempting to damage severely the South African economy will not provide the incentives for genuine change that we seek. U.S. firms in South Africa promote beneficial change. If we prohibited economic relations and thereby removed our firms from the scene, they would no longer be able to promote change.

-- The proposed measures would harm the majority, non-white population of South Africa more than they would help it.

-- The measures would harm United States banks, investors, and business firms.

Since the statements by officals of the Departments of State and Commerce cover in detail foreign policy considerations, codes of labor conduct and related matters, I shall focus my remarks particularly on the effects of the President's September 1985 economic measures and the legislative proposals to ban U.S. investment, to prohibit imports and further restrict exports, and to deny tax credits to U.S. investors.

Ban on Imports of Krugerrands

The proposed statutory ban on importation of Krugerrands, found in Section 4 of H.R. 997, is unnecessary. The importation of Krugerrands is already prohibited under President Reagan's Executive Order 12535 of October 1, 1985, and became effective on October 11, 1985. As was stated in the October 1, 1985, White House Message to Congress, the Krugerrand ban "was taken in recognition of the fact that the Krugerrand is perceived in the Congress as an important symbol of apartheid. This view is widely shared by the U.S. public." President Reagan directed this prohibition "in recognition of these public and Congressional sentiments."

Treasury, including its Office of Foreign Assets Control which administers this sanction, has received no indication of any evasion of this ban. This sanction has had a significant impact on total South African exports to the United States. In

1984, the last year of "normal" Krugerrand exports to the United States, total South African exports to the United States were $2.49 billion. In 1985 total South African exports to the United States declined by $410 million. As for Krugerrands, we estimate that approximately 1.3 million ounces of Krugerrands were exported to the United States in 1984, with an approximate value of $400 million; in 1985 we estimate that roughly 300,000 ounces of Krugerrands were exported to the United States, all prior to the imposition of the ban. Today, no Krugerrands are being imported.

Ban on Bank Loans to South African Public Sector

Last September, the President also imposed a ban on most types of U.S. bank loans to the South African Government, including public sector entities such as power companies and the agricultural marketing boards. The ban, for example, prevents U.S. export financing where the importing entities are in the governmental sector. Treasury's Office of Foreign Assets Control has promulgated regulations to carry out this ban, and has received no indication of any effort to evade this measure.

Total U.S. bank claims on South Africa in September 1985 were $3.4 billion. But only a small portion of these claims, about five percent or $180 million, represented direct lending to South African public sector entities. The amount is small because over a period of several years U.S. banks of their own accord had greatly reduced their claims on the public sector of South Africa.

The U.S. ban on bank lending to the South African Government was one of several measures aimed against the machinery of apartheid. This action followed other developments.

U.S. banks independently froze and then reduced their credit lines to South Africa, mostly affecting the private sector. The U.S. banks' actions were taken in late July and August of last year as a result of, among other events, President Botha's declaration of a state of emergency. The banks' decisions to freeze and reduce their credit lines and the further erosion of international confidence in South Africa and its currency led to a declaration by the South African Government in early September of a moratorium on repayments of principal on much of the country's foreign debt owed to banks. U.S. bank claims on South Africa's private sector have in effect been frozen as a result of this action, and will decline if debt is repaid without the benefit of new loans. Therefore, the overall effect of the U.S. ban coupled with independent actions of U.S. banks and the South African Government itself are likely to result in a continued decrease in U.S. bank claims on South Africa.

Disinvestment and Ban on New Investment

Let me now turn to the sanctions approach found in H.R. 997. As you know, Mr. Chairman, this Administration has a long-standing policy not to restrict market oriented investment flows. In the case of South Africa, this goal and our mutual concerns for the economic and social well-being of non-whites in South Africa are best served by not requiring disinvestment and not banning new investment. I should note, however, that owing to market forces, there was a $500 million net decline in the outstanding amount of U.S. direct investment in South Africa at the end of 1984, the latest year for which we have data.

The Impact on the Non-White Community. A ban on new investments in South Africa and/or a requirement that U.S. firms disinvest would have some impact on the employment of non-whites in South Africa and on the exemplary labor policies practiced by U.S. firms with operations in South Africa. U.S. firms operating in South Africa are important employers of non-whites and a major source of pressure for change in South Africa's policies. In fact, according to U.N. data, two-thirds of the employees of foreign owned firms in South Africa are black. Limiting the ability of these firms to bring in new capital, to grow or to adjust to market conditions, or requiring that they leave South Africa, could reduce job opportunities for non-whites. The white South Africans who might buy these firms may hire a smaller percentage of blacks than foreign investors do. The level of unemployment among blacks is already extremely high--about 25 percent according to some observrs. Any reduction in foreign investment would retard the South African economy's growth rate and its ability to absorb new non-white entrants into the job market.

Replacement by Other Investors. Although the United States is the third largest source of direct investment in South Africa, an ending of new U.S. investment flows or the sale of existing capital assets is not likely by itself to create a long-term anger for the South African economy. Other countries (Japan, the United Kingdom, West Germany) have significant commercial interests in South Africa, and their firms which also compete with us in world markets, or South African firms, would fill gaps left by departing U.S. firms. South Africa also has demonstrated its ability to develop efficient indigenous production in the face of international sanctions, such as in its arms industry.

Adverse Impact on U.S. Investors. U.S. firms would also be placed in a precarious position by a ban on new investment or a requirement to disinvest. A large portion of U.S. investment in South Africa is in those sectors where there are numerous competitors--automotive vehicles, pharmaceuticals, petrochemicals and computers. A ban on new investments would limit established U.S. firms' capacity to adjust to the dynamics of the market and, without the ability to make new investments, ultimately could force many firms to withdraw. This could be extremely costly to the firm. Firms would likely be forced to sell their assets at a price well below market value. The likely buyers--white South Africans and non-U.S. foreigners--would reap windfall gains from the forced sale of U.S. firms. In addition, the buyers would likely have less interest in maintaining and encouraging non-discriminatory practices in the workplaces than U.S. firms do. It is hard to see the point of a policy that would: a) confer windfall capital gains on white South African investors and our worldwide competitors at American expense, and b) weaken our stance against discriminatory practices in the workplace.

Blocked Transfers. If faced with disinvestment, the South African Government could effectively block the transfer of the proceeds of the divested assets from South African rands into dollars. In this situation, U.S. investors would hold inconvertible South African rands, which for all intents and purposes would be worthless. Even if transfers were not blocked, the U.S. investor would be paid in "financial" rands, which, under South Africa's present system, can only be converted into foreign exchange by selling to another foreign investor. With U.S. investors forced to divest, under the proposed legislation, the resulting downward pressure on the financial rand would reduce even further the dollar value of the realized assets.

Denial of U.S. Tax Credits

The Treasury Department opposes the proposed denial of credits or deductions for South African taxes because a denial would violate both U.S. treaty obligations and sound tax policy.

Our bilateral income tax treaty with South Africa was signed in 1946, and a protocol was signed in 1950. The treaty was ratified in 1952. Though statutory override of treaty obligations is possible within any system, as indicated below, we consider it to be a highly undesirable step as the effect would be to penalize U.S. firms, not South Africa.

The United States taxes U.S. citizens and residents, including U.S. corporations, on their worldwide income. When a portion of that income is earned in a foreign country, the foreign country will generally also tax that same portion. As a result, the same items of income may be subject to double taxation. To avoid such international double taxation, the United States permits foreign taxes paid on income earned outside the United States to be credited against U.S. tax. To preserve the U.S. tax on U.S. income, the foreign tax that may be claimed as a credit is limited to the U.S. tax that would otherwise be due on the foreign income.

Denial of credits would have a very uneven impact across U.S. companies depending on whether they operate only in South Africa or in other countries as well, and depending on the effective tax rates which they face in South Africa and in other countries. For companies with foreign taxes paid to third countries in excess of the U.S. tax on foreign income, the denial of credit for South African tax while continuing to allow credit for high third country tax would probably have little impact on U.S. firms' desire to do business in South Africa. U.S. multinationals which operate in South Africa have major operations in such high tax countries as Germany, Canada and the United Kingdom.

On the other hand, for a U.S. company paying foreign taxes which are below the U.S. tax on foreign income, the proposed denial of credit would result in the double taxation of income earned in and taxed by the Republic of South Africa. The combined U.S. and South African tax rate on this income could be as high as 85-90 percent as a result of the proposal. Thus, in the latter case it is the U.S. investor who suffers. This may well drive him out of South Africa, and will, as indicated elsewhere in my testimony, lead to his replacement by other foreign or South African firms at bargain basement prices.

The United States foreign tax credit is based on sound tax policy. It conforms with accepted international practice by according to host countries the primary right to tax income earned in that country and placing on the home country the obligation to relieve double taxation. Furthermore, the United States is obligated to relieve international double taxation of income earned by U.S. citizens, residents and corporations in South Africa by our income tax treaty with South Africa. This treaty obligation would be directly violated by the proposed legislation. If the United States, because of unilateral overrides of treaty benefits, is seen by our treaty partners and potential partners as taking our treaty obligations lightly, they will be less likely to make concessions. Our entire tax treaty program will be weakened, with the result that foreign treaty benefits for U.S. businesses will be more difficult to achieve elsewhere in the world.

This is an example of how, while it might not be apparent at first glance, an action motivated by laudable intentions would have serious adverse implications that go far beyond these intentions. This action would significantly harm U.S. tax treaty policy, and in any event will have little overall impact on South Africa.

Trade Ban

Finally, the Treasury Department firmly opposes the measure proposed in H.R. 997 to prohibit all South African imports into the United States and to ban most exports. It is an unavoidable fact that critical industries in the United States are dependent upon imports of ferrochromium, platinum, and manganese from South Africa. The United States currently imports from South Africa approximately 60 percent of U.S. ferrochromium requirements, 80 percent of its platinum group metals (necessary for catalytic converters), and 65 percent of its industrial diamonds requirements. A ban against importation of these goods from South Africa would require large switching of sourcing to obtain these vital materials. This would result in higher costs, particularly for our beleaguered steel industry, and the Soviet Union, which also supplies these minerals, would obtain a windfall.

With reference to exports, you are aware, Mr. Chairman, that the United States Government currently has in place comprehensive controls on exports to South Africa covering military and dual-use items, computers, and nuclear technology. All these controls focus pressure on the South African Government, its defense agencies, and those agencies which enforce the policies of apartheid.

A total ban on exports would impact on our exports sector;in fact U.S. exports to South Africa declined by $1 billion last year. It would also have a grave impact on the South African people and its economy, denying them goods and services necessary for a healthy economy. We believe it would be wrong to target the South African people. The President's Executive Order was aimed at the South African Government and its enforcement of apartheid.

Conclusion

In summary, Mr. Chairman, we recognize the pressures to respond strongly to South Africa's policies, and the Congress's genuine attempts to develop a sound approach. In fact, the financial markets have already recognized the increased risks of doing business with South Africa. Nevertheless, Treasury's examination of the types of measures proposed in legislation such as the largely punitive economic actions contained in H.R. 997, in terms of their potential for promoting change and their effects on U.S. interests and the interests of non-whites in South Africa, leads to the conclusion that the proposed measures would be ineffective, counterproductive, or both. We believe the proposed sanctions in H.R. 997 would not produce the changes we all seek, but would damage interests we would like to promote and defend. Such sanctions would further disadvantage the non-white population in South Africa, and would have adverse, perhaps significant and long-standing, effects on U.S. Government and private economic interests and on our ability to influence events in a positive fashion.

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TREASURY NEWS

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

STATEMENT OF THE HONORABLE JAMES A. BAKER, III
SECRETARY OF THE TREASURY
OF THE UNITED STATES

BEFORE THE MEETING OF THE IMF INTERIM COMMITTEE
APRIL 9-10, 1986
WASHINGTON, D.C.

The Functioning of the International Monetary System

This meeting provides an important opportunity to advance our work in developing a broad international consensus on measures to improve the functioning and stability of the international monetary system. It is the first occasion for substantive discussion in this Committee of the G-10 and G-24 reports, representing one more step in our efforts to strengthen the system in a way that helps us all achieve our basic goals of high sustainable growth, low inflation, and open markets.

The current international monetary system has both strengths and weaknesses. It has provided a useful framework for responding to the multiple global economic shocks of the 1970's and early 1980's. And recent cooperative efforts have helped produce greater convergence of favorable economic performance and more consistent policies among the major industrialized nations. This has contributed to exchange rates which are more in line with fundamentals, helping set the stage for a reduction in large external imbalances.

This progress notwithstanding, the system continues to have weaknesses which need addressing, both in terms of the framework within which our economies relate, as well as in terms of underlying policy and performance weaknesses. The U.S. is committed to work with others in an effort to find the best ways to strengthen the system. We need to improve the functioning of the system, not only to help us deal with the economic problems we face, but to help avoid such problems in the future.

The reports of G-10 and G-24 offer some useful suggestions for improvements in the operation of the international monetary system. They bring out a number of areas of broad agreement, as well as areas where views diverge. We continue to support the general thrust of the G-10 report as a good step in the right direction, deserving of prompt implementation where possible. In particular, the IMF Executive Board should implement the surveillance recommendations in the G-10 report as well as the proposal for increased publicity for abbreviated assessments by the Managing Director of countries' policies and performance. In addition, ideas to revise and strengthen the surveillance principles and procedures have been developed, and we support further steps in this direction. I am pleased that work is already underway to do just that.

The IMF Executive Board has looked at a range of issues relating to the strengthening of the international monetary system, as outlined by a report by the Managing Director. This is a good beginning, but more work, analysis and study need to be done. I do not believe this Committee needs any special group to be formed for follow-up work. We should continue work in the Executive Board, and ask our Executive Directors to report back to us in the fall for further substantive Interim Committee discussion.

In our effort to develop realistic, effective and pragmatic arrangements, a number of general points need to be considered. First, the basic objectives of any strengthened system should be:

1. To maximize economic growth consistent with price stability and sustainable balance of payments positions; and

2. To help maintain an open, stable system of trade and payments.

Second, there must be a basic foundation of improved international cooperation and policy commitment by all countries for any strengthening of the international system to work. Recent developments suggest that such a foundation is emerging, but we must all see to it that this cooperation is a lasting feature of the system.

Third, we believe that there are a number of qualities that we should be looking for in any strengthened system. Five that I would mention are:

1. Symmetry: A stengthened system should encourage countries to follow sound, growth-oriented, consistent policies in a symmetrical fashion, applied even-handedly to surplus as well as deficit countries, to small countries as well as large.

2. Policy breadth: The problems that underlie the external imbalances and exchange rate volatility of recent years, have been multifaceted, stemming from

policy and performance insufficiencies in a number of areas, including fiscal, monetary and structural policies. It is important, therefore, that a strengthened system be able to address potentially a range of policies and problems in order to promote convergence of favorable performance and more consistent policies.

3. Flexibility: Any system needs to have adequate flexibility to respond to exogenous developments and allow for differences in performance among countries Recent oil price developments have underscored the need for flexibility in the system.

4. Automaticity: That being said, it can be argued that the current system has too much flexibility. Any strengthened system should, therefore, contain a somewhat greater degree of automaticity in addressing problems that develop.

5. Political will: It is all well and good to say that there must be political will. But the issue for strengthening the system is not so much whether there is sufficient political will, but what system can best help each of us in our efforts to muster the political will to do what is right.

With these considerations in mind, we should continue our efforts to find approaches which embody these qualities. We clearly need further work to do that.

We have approached today's discussions with an open mind. I look forward to working together with you in our continuing search for ways of improving the functioning of our international monetary system.

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

FOR IMMEDIATE RELEASE April 8, 1986

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All other particulars in the announcement remain the same.

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TREASURY NEWS

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

FOR RELEASE
APRIL 8, 1986

CONTACT: BOB LEVINE
566-2041

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

AT THE
CARTER CENTER DEBT CRISIS CONFERENCE
EMORY UNIVERSITY
ATLANTA, GEORGIA

APRIL 8, 1986

The U.S. Debt Initiative:

Toward Stronger World Growth

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 want to hear detailed statistics, but let me illustrate with a few simple numbers. 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 $420 billion, is owed to the private commercial banks and $120 billion to U.S. 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 as its first and foremost element 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. As you all know, the Plaza agreement has resulted in a major change in relative exchange rates. But we should also bear in mind that the agreement involved much more than just exchange rate adjustment. The Plaza statement recognizes that solid, low inflation growth and open markets in the industrial countries are an essential prerequisite for stronger world growth.

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 are crucial not only to growth within the industrial nations, but also as a basis for growth-oriented reform in debtor nations.

Changes in the global economic environment are already having a beneficial impact on the prospects for future growth. The 35 percent decline in the dollar versus the yen and deutsche mark since February 1985 will help to improve the competitive environment for U.S. industry both at home and abroad. The U.S. trade deficit in 1986 should be about $20 billion lower than we expected as recently as last fall. For 1987, the deficit should drop below $100 billion -- without, I would emphasize, resorting to protectionist solutions and with continued solid growth in the U.S. economy.

Interest rates have also declined sharply in recent months in reflection of both the U.S. commitment to Gramm-Rudman budget deficit reduction and falling oil prices. U.S. short term rates have fallen from over 11 percent in 1984 to 7.5 percent, very similar to the decline in LIBOR rates over this same period. U.S. long term interest rates have similarly declined from 13.5 percent to 9.5 percent during this period.

You don't need to be reminded of the importance of interest rate changes of this magnitude for U.S. businessmen. However, they are also very important for debtor nations. The major debtor countries are expected to save $7-8 billion in interest payments on their debt this year alone.

The dramatic reduction in oil prices is expected to give further impetus to stronger growth and lower interest rates in the industrial nations in the period ahead. This will provide indirect benefits for most developing countries, in addition to the direct benefits from reduced oil import costs. Thus, the difficulty experienced by oil exporters ought not to obscure the stimulus to recovery and growth which the fall in oil prices provides to the global economy as a whole.

Although both the G-5 initiative and the debt initiative are well advanced, there remains a considerable amount of unfinished business in both areas. I would like to summarize for you a few of the tasks yet before us.

In his recent State of the Union address, President Reagan recognized the serious problems for American farmers and exporters caused by substantial exchange rate variability. He called for closer economic coordination among the major trading countries and directed Secretary Baker to determine if the nations of the world should convene to discuss the role and relationship of our currencies.

Discussions on the need to improve the international monetary system are currently underway in the Interim Committee of the IMF which Secretary Baker will be attending in April. The present flexible exchange rate system has served us well these past 15 years in dealing with a world economy faced with multiple economic shocks. However, the system has had its weaknesses and there is a need to reduce the kind of exchange rate variability which has characterized the system in recent years. A consensus is emerging that greater exchange market stability depends critically on achieving better convergence of favorable economic performance and compatible policies among the key currency countries.

The fundamental issue is how to encourage sovereign nations to pursue mutually consistent and reinforcing policies. The G-5 Plaza agreement represented a major advance in economic collaboration. The Interim Committee will consider recommendations to strengthen the IMF's ability to promote sound, consistent policies which move in the right direction. However, the United States is convinced that more can and should be done. We will approach the April meetings with an open mind and will consider realistic measures that could command wide support.

With regard to the debt situation, 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 contributions will necesarily focus primarily on macroeconomic policy, rather than long-term structural reforms.

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 as opposed to the more traditional project 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.

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, the commercial banks. 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.

When is the debt initiative going to begin?

The answer very simply is that it <u>has</u> 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.

Assistance for the Poorest Nations

My remarks so far today have dealt with the major debtor countries. I would like to turn now to the poorest countries, particularly in Sub-Saharan Africa, many of which have seemingly intractable economic problems, including serious debt-related difficulties.

The economic situation in Sub-Saharan Africa has worsened significantly in recent years. A combination of factors has been responsible for the decline -- extended drought, falling commodity prices, effects of the recession in the early 1980s, and, importantly, the absence of sound economic management in many of the countries in the region. GDP per capital declined for the region as a whole by over ten percent between 1980 and 1983.

As a result of these problems, many African countries have experienced protracted balance of payments problems. While many have made use of IMF credits, the deteriorating balance of payments situation has led to an increased number of reschedulings and, in several cases, the build-up of arrears to the IMF.

It has become increasingly clear that the economic and financial problems facing African countries will require long-term solutions. While IMF programs can deal with some of the short-term balance of payments difficulties of these countries, restoration of sustainable growth will also require structural economic reforms for which an institution such as the World Bank is better suited.

Recognizing this, Secretary Baker, at the Seoul IMF/ World Bank meeting, proposed a program for dealing with the African economic situation. This proposal called for using reflows to the IMF Trust Fund in conjunction with World Bank resources to provide additional financing to poor countries with protracted balance of payments problems which are willing to undertake comprehensive economic reforms.

After months of intensive consultations in the international community, the IMF and the World Bank Boards recently approved the U.S. proposal. The Trust Fund arrangement will enable the IMF, World Bank and the recipient country to work together to develop a comprehensive policy framework which will serve as the basis for separate lending agreements between each of the institutions and the recipient government.

This approach will seek to remove structural impediments to production, savings, investment and non-inflationary growth. Each program will include both macroeconomic and structural components, tailored to the needs of the individual countries.

Under the arrangement, staff of the IMF and World Bank will work with the recipient country to develop a policy framework which will involve consistent, supportive macro-economic and structural policy objectives, and to determine areas for priority attention. Fund and Bank staff will also reach general agreement on financing needs and sources to support the comprehensive program.

Funding resources to implement the arrangement will include $3.1 billion in reflows to the IMF Trust Fund and roughly equivalent resources from the World Bank, primarily through IDA, the soft-loan window of the Bank. In addition, we hope that the development of a coherent policy framework for borrowing countries will catalyze bilateral contributions to be utilized in association with Trust Fund arrangement programs.

We were extremely pleased by the IMF and World Bank Boards' decisions to support our proposal. Comprehensive economic policy reform is the most important step toward countering economic stagnation in the poorest countries and setting the stage for a resumption of sustainable growth. This arrangement provides those governments with the wisdom and determination to set their economies on the course to growth to have access to the resources necessary to finance the difficult adjustments which they will have to undertake.

The Trust Fund arrangement also signals a new step in coordination between the IMF and the World Bank. The Fund has always focused its programs on dealing with short-term balance of payments difficulties, primarily through macroeconomic policies. The World Bank, on the other hand, is a development institution with greater familiarity working on structural problems in developing economies. Creating an arrangement where they can bring their complementary expertise to bear on the complex economic problems facing the poorer countries will result in benefits to the recipient countries and the capabilities of both institutions.

The Trust Fund arrangement also provides an opportunity to increase coordination among bilateral donors, who have traditionally pursued their aid programs in specific countries without systematic thought to whether their programs were consistent with those of other donors. Under the Trust Fund arrangement, consultations among bilateral donors, multilateral institutions and the recipient country can be strengthened, leading to more coherent aid programs and ultimately more rapid development.

Conclusion

The substantial exchange rate changes that have occurred since the Plaza agreement last September will help to reduce the large trade imbalances among the major countries. However, in an effort to improve the functioning of the system, we now need to focus on ways to achieve greater growth in Europe and Japan and continued improvements in access to Japanese markets in order to reduce substantially the large imbalances that will remain in the system. Our own success in implementing Gramm-Rudman budget deficit reductions and accomplishing tax reform will also be important. Finally, a new round of trade negotiations should give further impetus to global growth through the mutual reduction of trade barriers.

If the debtor nations also do their part in adopting growth-oriented reforms -- and they are supported in their efforts by additional lending from the international financial institutions and the commercial banks -- the debt situation should be both manageable and containable in the period ahead.

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DEPARTMENT OF THE TREASURY

STATEMENT OF THE HONORABLE JAMES A. BAKER, III
SECRETARY OF THE TREASURY
OF THE UNITED STATES

BEFORE THE MEETINGS OF THE
INTERIM COMMITTEE OF THE INTERNATIONAL MONETARY FUND (IMF)
AND DEVELOPMENT COMMITTEE OF THE WORLD BANK AND THE IMF

APRIL 9-11, 1986
WASHINGTON, D.C.

The International Debt Situation: Improving the Prospects for Growth

These meetings provide an important opportunity to continue the informal dialogue begun in the Interim and Development Committees last April. Those discussions were very useful in focusing our attention on prospects and policies for the medium term, particularly for heavily indebted developing nations.

One of the most important developments during the past year has been the emergence of broad agreement among both creditor and debtor nations that improved growth in the debtor nations is essential to any resolution of the debt problem. Debtor countries must be able to create real resources -- and export earnings -- at a faster pace than they are accumulating debt. Sustainable growth with adjustment must therefore be the central objective of our debt strategy.

Steady growth, low inflation, and open markets in the industrial nations are critical to provide a firm foundation for stronger growth in the debtor nations. Considerable progress has already been made in this area in recent months. The individual policy intentions announced by the major industrial nations last September in New York 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 the private sector and to overall 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 and reduce both nominal and real interest rates over time -- thereby passing on the benefits of growth. The fruits of these and previous economic policy efforts are already becoming evident:

- Stronger industrial country growth and lower inflation this year should add $5 billion to developing nations' non-oil exports and reduce their import costs by $4 billion.

- The substantial reduction in both short and longer-term interest rates since early 1985 should reduce debt service payments for developing countries by $11 billion or more annually.

- Lower interest rates, stronger industrial country growth, and the recent dollar depreciation should also help to improve the outlook for commodity export earnings.

The sharp decline in oil prices will also help most debtor nations through reduced oil import costs, stronger growth and further interest rate reductions in industrial nations, and increased trade opportunities. We estimate that it will reduce oil import costs for oil importing developing nations by an additional $13 billion this year. While the financing needs of the oil exporting developing countries will increase, we believe these requirements can be managed within the overall framework of the debt initiative we have proposed.

Indeed, these economic developments suggest that during the next two years developing nations will face the best external environment since the early 1970s, providing a solid foundation for their own efforts to strengthen growth.

Nevertheless, our debt strategy cannot rest on growth in the industrial nations alone. The adoption of growth-oriented macroeconomic and structural policies by the debtor nations themselves is essential to permit them to take full advantage of improved opportunities in global markets and to strengthen the domestic foundations for growth for the longer term. Of key importance will be policies designed to enhance domestic savings, encourage increased portfolio and equity investment, and stimulate the return of flight capital.

The U.S. Initiative for Major Debtors

As you know, at last October's Annual Meetings of the IMF and the World Bank I proposed a "Program for Sustained Growth" for the principal debtor countries, involving three essential and mutually reinforcing elements:

-- the adoption by debtor nations of comprehensive macroeconomic and structural policies to improve growth and reduce inflation;

-- a continued central role for the IMF, in conjunction with increased and more effective structural adjustment lending by the multilateral development banks; and

-- increased lending by the commercial banks in support of debtors' reform efforts.

Our initiative was designed to strengthen the current international debt strategy by focusing on the need for growth. It also recognized that without economic reform in the debtor nations, no amount of money -- whether derived from external borrowing, financial aid, or inflationary domestic pump-priming -- will produce sustainable growth.

Increased financing can be useful in facilitating and supporting domestic policy shifts to increase economic growth. But additional borrowing would be imprudent, and merely increase the total debt burden, in the absence of credible policy measures to assure that any new financing is used efficiently and productively.

Net new lending and growth-oriented policy reforms must be closely linked to maintain the confidence and support of the international financial community and to permit total debt to be reduced significantly over time. That is the essence of the debt initiative we have proposed.

Our proposal envisages:

-- a 50 percent increase in World Bank and IDB disbursements to the principal debtors, to $9 billion annually in 1986-88, or about $20 billion in net new credits over this period, after scheduled repayments; and

-- $20 billion in net new lending by the commercial banks over the same period in support of growth-oriented policies by the debtor nations.

The response to the U.S. proposal from all quarters has been positive and confirms our conviction that the focus of the initiative on these three main elements is correct and holds the greatest hope for realistic forward momentum. It has been endorsed by a number of key industrial countries, and by an unprecedented joint statement of support by the Managing Director of the IMF and the President of the World Bank. The President of the Inter-American Development Bank (IDB) has also supported the initiative, and member nations are currently considering IDB reforms to assist in its implementation. National banking groups in the seven Summit countries, the Netherlands, Sweden and Saudi Arabia, as well as major individual banks in other creditor countries have also voiced their support for the proposal.

Finally, the Cartagena and Group of 24 developing countries have welcomed the initiative's emphasis on growth and enhanced financial assistance.

I recognize that there are differing views on whether the amount of financing we have called for is sufficient. Clearly, the amount of financing needed for individual debtors will vary to some extent with major changes in the global economic environment, including the recent sharp decline in oil prices and interest rates. Total financing needs therefore are not set in concrete.

Nevertheless, I believe that the $40 billion in net financing flows from the commercial banks and the multilateral development banks which we have called for will meet the needs of debtor nations if genuine reforms are undertaken. World Bank estimates support this judgment, based on industrial country growth in line with current forecasts.

Moreover, if this approach is successful in generating the needed reforms, I have no doubt that additional financing will be forthcoming, if subsequently needed.

There has been a tendency to talk about the debt initiative as the "Baker plan", as if this were a blueprint for a quick solution. I would prefer to view it as a multilateral debt initiative reflecting common agreement on how to proceed in helping debtor countries overcome their financial debt problems.

The debt initiative provides a cooperative framework for efforts by the debtors themselves, supported by the international financial institutions and the commercial banks. The policy measures which are needed will vary from country to country, depending on their own economic situations. The development of medium-term economic programs will ultimately be their own responsibility, but must be credible in order to gain IMF, World Bank, and commercial bank support. This process of returning debtor countries to creditworthiness and voluntary borrowing will take time.

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 too often fallen short of producing lasting reform within their domestic economies. Many have failed to control adequately government budget deficits. While some progress has been made in reducing inflation, in most countries inflation remains too 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.

Structural problems have also received inadequate attention in many countries. Structural reforms are a necessary foundation for stronger growth and to reverse the capital flight which has plagued these economies. These include the development of more efficient domestic capital and equity markets, increased efficiency and privatization of public enterprises, growth-oriented tax reform, improvement of the environment for both domestic and foreign investment, trade liberalization and the rationalization of import regimes.

Such reforms are difficult. I recognize that many of them touch on sensitive political issues, while their benefits may become visible only over the longer term. But determined efforts must be made to address these problems if sustainable growth is to be achieved.

It will be important that these efforts be supported by the international financial institutions.

The IMF's role should continue to be a catalytic one, providing policy advice and where appropriate, temporary growth-oriented economic programs which can catalyze additional capital flows. Supporting sound macroeconomic policies, particularly fiscal, monetary and exchange rate policies, is an essential part of that effort. Without the creation of a stable financial environment and market-oriented exchange rate policy that can promote competitiveness and help avoid capital flight, other policy changes are likely to be of only marginal effectiveness.

But with such an environment, it is important that structural problems be aggressively addressed in order that a broad basis for growth and adjustment be established. Accordingly, it is also very important that the Fund give increasing attention in its programs to structural policy changes which are necessary to establish the basis for sustainable growth and balance of payments adjustment. Pricing policy, public enterprise reform and divestiture, tax reform, financial sector development, trade liberalization, and labor market reforms are among those areas which merit increased attention in Fund-supported programs.

The Fund has, in fact, been addressing these areas with increasing frequency, and we welcome the progress that has been achieved in this aspect. But such growth-oriented policies have not always been given adequate priority in Fund supported programs, and we look for further adaptation of Fund lending policies, including greater use of review clauses, in order to help assure a growth orientation to such programs. The actual policy coverage and mix would be determined on a case-by-case basis in light of the circumstances of the country concerned.

In most cases, we will expect Fund support to continue to take the form of stand-by arrangements, but it must be remembered that IMF financing is temporary, and it is natural and appropriate that such financing not continue over a lengthy period of time. Thus, we welcome the development of other techniques of Fund support, such as "classical" stand-bys and enhanced surveillance, to be used in selected cases.

The Fund's approach to structural policies also will need to be developed in close cooperation with the World Bank, whose mission is strongly focused on longer-term development issues. The World Bank already has considerable experience in addressing the kinds of structural problems that most debtor countries face and will play a key role in this area. We expect that much of the World Bank's new lending will be fast-disbursing sector and structural adjustment loans as opposed to the more traditional project loans.

The World Bank currently has ample capacity to increase annual lending commitments by some $2-2.5 billion above FY 1985 and to concentrate that lending more heavily on the large debtors with credible reform programs. The United States is 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.

The World Bank is already moving ahead to strengthen procedures and policies to implement this expanded role. It is currently assisting major debtors in the development of medium-term adjustment programs which emphasize the mobilization of domestic savings, a more attractive investment climate, rationalization of the public sector, removing price distortions, and trade liberalization. It also plans to implement procedures which will streamline operations and provide for a more comprehensive review of lending priorities for individual countries. Finally, Bank staff are working with private creditors in considering ways to better mobilize additional support for debtors' adjustment programs.

It will be essential for the IMF and the World Bank to establish a closer working relationship as part of this process to assure that macroeconomic and structural policy measures are consistent and mutually supportive.

Significant progress has already been made in improving cooperation between the two institutions, including recent experience in coordinating World Bank structural or sectoral loans with IMF programs in Chile, Ecuador, the Ivory Coast, the Philippines, and Uruguay, among others. In these cases, collaboration between the two institutions has extended to catalyzing commercial bank support.

We believe these efforts are on the right track and should be continued. Development of a formal cooperative framework for implementation of the initiative, however, does not appear to be necessary at this point. The mechanisms for cooperation -- and for triggering commercial bank lending -- will necessarily vary for individual countries.

Some of the larger debtors will need to take advantage of all of the elements of the strategy: an IMF program, enhanced sectoral or structural adjustment loans from the multilateral development banks, and new money packages from the commercial banks.

Mexico and Argentina are among a number of countries moving in this direction. Mexico is discussing a new program with the IMF, and working with the World Bank on sector loan programs. Argentina has a program with the Fund, and a follow-on program is planned. Last week the World Bank approved an agricultural sector loan for $350 million for Argentina as the first in a series of contemplated loans linked to policy reforms. The Philippines should also be able to benefit from a comprehensive approach.

A number of other nations, such as Colombia and Uruguay, 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. Ecuador fits in this group and has recently completed negotiations on World Bank loans for the agricultural and industrial sectors totaling $215 million. Ecuador is also negotiating a new IMF standby program to replace the one which expired last month. Other countries are at different stages of implementing comprehensive, growth-oriented economic programs.

Implementation of the debt initiative, therefore, will depend on the pace of negotiations between individual debtor nations and the international financial institutions. If the IMF and World Bank place greater emphasis on sound, market-oriented policies to improve growth and promote adjustment -- which we believe is happening -- and the debtor nations move decisively in this direction, I am confident that new commercial bank lending can be counted on to support these efforts.

Let me mention here two areas which deserve special attention: efforts to improve both domestic and foreign investment in the debtor nations and the importance of trade liberalization and trade finance.

Foreign investment must be an important component of our growth strategy. It is non-debt creating financing, and therefore doesn't increase the debt service burden. It also can provide a vehicle for the return of flight capital and a significant stimulus to entrepreneurial dynamism, increased efficiency, transfer of technology and managerial know-how which can facilitate structural change and growth. A hospitable climate for both domestic and foreign banking institutions would improve the efficiency and resource mobilization capability of the local market. This will also improve opportunities for swapping debt for equity, which has already had some success in some of the Latin American countries.

For most developing nations, however, both domestic and foreign investment has fallen significantly in recent years. Foreign direct investment in developing countries has declined from 20 percent of total flows in 1975 to just 11 percent in 1984. A number of factors underlie these trends, including:

- -- the increased availability of commercial bank financing during the 1970s;
- -- domestic retrenchment and capital flight in response to the debt crisis during the early 1980s;
- -- the imposition of new restrictions and performance conditions on foreign investment; and
- -- perceptions of increased political risk on the part of foreign investors, and poor growth prospects for the economy as a whole.

Reversing this trend, like reversing capital flight, will depend on a number of factors:

- -- First, the adoption by debtors of sound macroeconomic policies, including positive real interest rates, realistic exchange rates, market-related prices, and a concerted attack on inflation;

-- Second, liberalizing investment regimes, which will signal investors of a more stable, predictable, and transparent policy environment over the longer run; and

-- Third, enhanced assurance against political risk, including expropriation and uncertainty about foreign exchange convertibility.

Support for the creation of the MIGA can help to encourage the flow of investment both to and among developing countries, through encouraging needed policy reforms as well as through its political risk and dispute settlement activities. We believe that the MIGA can make an important contribution to economic growth and development and look forward to participating in this new institution. Participation by developing countries in the negotiation of global rules governing foreign investment in GATT as part of the new round of trade negotiations could also help to improve the investment climate.

Global trade liberalization and expansion through the new trade round can provide a further boost to growth in the debtor countries and deserves their active support and participation. It does not make sense for these nations, however, to delay trade policy reforms in their own economies which can contribute to stronger growth while awaiting the completion of global trade negotiations. The United States is therefore prepared to consider giving credit in the new round for trade liberalization measures adopted as part of debtor nations' domestic policy reforms, and subsequently bound in the GATT negotiations. We hope other industrial countries will show a similar willingness to give appropriate credit for these measures.

We are also concerned about the need for continuing availability of adequate trade finance to support increased trade with the developing nations. Lending by export credit agencies to countries which adopt sound adjustment measures is an important complement to both private and multilateral lending.

Officially supported trade finance is crucial to maintaining essential imports in support of adjustment efforts. It also can serve as a catalyst for further private finance as well as give the debtor an incentive to adjust. In this regard, it is important that export credit agencies continuously evaluate their cover policies in light of changing debtor situations. We believe that in many cases present policy is too restrictive. Adjusting countries are penalized if creditor countries automatically go off cover when a country seeks to restructure its debt. We believe that conclusion of a Paris Club rescheduling offers an excellent opportunity for countries to consider liberalizing export credit cover policies for countries which are adjusting.

Individual export credit agencies will continue to make decisions on cover policy for a particular country on a case-by-case basis in light of national policies and priorities. Nevertheless, the IMF and the World Bank can play an important role by increasing transparency with regard to both other creditors' cover policies and the debtor's adjustment measures and priorities. Such increased transparency may well encourage some export credit agencies to resume cover more quickly.

Assistance for the Low-Income Countries

Last fall in Seoul, when we reviewed economic conditions in low-income countries, the situation was discouraging. The countries in the region were beset by low economic growth, mounting arrears on their financial obligations; and, in a number of cases, famine and drought.

The economic conditions and prospects of these countries now seem somewhat brighter. As the World Bank report indicates, the low-income countries of Sub-Saharan Africa, for example, could register real economic growth of 3.6 percent this year. This would allow for a positive, albeit modest, increase in their per capita income for the first time in many years.

The return of good rainfall and some commodity price movements have been helpful, but we are also beginning to see a payoff from policy reforms put in place by some low-income countries, including more realistic exchange rates, more market-oriented agricultural prices, and rationalization and privatization of inefficient state enterprises.

Despite such improvements, it remains clear that fundamental changes are required to restore economic growth and sustainable payments positions in these countries. Comprehensive macroeconomic and structural policies, supported by adequate external finance, are required in order to lay the basis for economic growth and development in the medium-term.

With these objectives in mind, the U.S. put forward a proposal for use of Trust Fund reflows, in conjunction with World Bank and other resources, to support growth-oriented policies in low-income countries with protracted balance of payments problems. As later modified, this proposal gained the support of the international community and was recently endorsed by the Executive Boards of the Bank and the Fund, with the Fund creating a new facility, the Structural Adjustment Facility (SAF), to implement the proposal.

I welcome the actions taken by both Boards, and I would like to take this opportunity to acknowledge the efforts of many who helped bring this effort to fruition.

The medium-term policy frameworks, which will be developed jointly by the Fund, the Bank, and countries concerned through joint missions, represent a major step forward in Bank/Fund collaboration. We believe that the policy framework papers, which will set forth problem areas and policy priorities and timetables for addressing those problems, can usefully guide the country and both institutions in developing annual programs. Such programs, developed within this framework covering both economic and structural policies, should have a higher likelihood of success. Importantly, the Policy Frameworks will also contain an assesment of external financing needs and indicative levels of financing from the Bank, and the Structural Adjustment Facility.

These frameworks can also help to catalyze additional bilateral resources and assure more effective and productive use of bilateral assistance. To that end, individual country Policy Framework papers can be shared with bilateral donors through consultative groups. We believe this can improve coordination of bilateral assistance efforts, and we support the suggestion in the World Bank President's report that the multilateral agencies assume a larger role in the aid coordination process. We look to the World Bank to take the leading role in this effort, and we hope that the Development Committee will endorse President Clausen's suggestion that progress in the area of donor coordination be reviewed at the fall meeting.

The comprehensive policy framework approach is based on a widespread recognition of the urgent need to address the serious and prolonged economic problems of low-income countries. The task that lies before us is to ensure that this new approach is effectively implemented. This will require, first and foremost, that the debtors take the needed policy actions. It will also require a high degree of cooperation between the Fund and the Bank.

We look forward to seeing the first framework papers developed by the Fund, the Bank, and the countries concerned. We look forward to the successful conclusion of the IDA VIII replenishment negotiations, which will provide a significant portion of the funding for the adjustment programs undertaken pursuant to the Policy Frameworks. IDA's increased emphasis on Africa is a significant aspect of the ongoing international efforts to address the problems of that region.

Conclusion

In summary, let me say that we are encouraged by the positive developments which have occurred in recent months. It is important, however, to maintain the momentum that already exists, because much still remains to be done. We believe that with a continued cooperative approach by all, the growth aspirations of debtor countries can be realized.

TREASURY NEWS

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

April 10, 1986

Michael R. Hill Appointed Inspector General

Secretary of the Treasury James A. Baker, III, has announced the appointment of Michael R. Hill as Inspector General of the Department of the Treasury. Mr. Hill had been Deputy Inspector General since March 1985, and was Acting Inspector General since January of this year.

As Inspector General, Mr. Hill will manage audits and investigations involving the Department's programs and operations.

Before coming to Treasury, Mr. Hill held several managerial positions from 1981 to 1985 at the National Aeronautics and Space Administration (NASA). These included Assistant Inspector General for Auditing, Acting Assistant Inspector General for Management Services, and Deputy Director of Headquarters and Special Projects.

From 1975 to 1981, Mr. Hill was an Accountant, Supervisory Auditor and Chief of the Cost Advisory Branch at U.S. Environmental Protection Agency office in Cincinnati. He served as Internal Auditor at the Navy Finance Center in Cleveland, Ohio, from 1973 to 1975. Previously, Mr. Hill was Assistant Credit Manager at the Sears, Roebuck and Company in Minot, North Dakota (1970-73).

Mr. Hill earned a Bachelors of Business Administration from Minot State College (1973), a Masters of Business Administration from Xavier University (1981), and is a Certified Public Accountant (CPA). He is married and has a son. Mr. Hill was born in Cincinnati, Ohio, on June 5, 1948.

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B-538

TREASURY NEWS

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

FOR IMMEDIATE RELEASE April 10, 1986

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,258 million of 52-week bills to be issued April 17, 1986, and to mature April 16, 1987, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	5.93%	6.30%	94.004
High -	5.95%	6.32%	93.984
Average -	5.94%	6.31%	93.994

Tenders at the high discount rate were allotted 65%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 13,220	$ 13,220
New York	24,807,635	8,312,385
Philadelphia	8,405	8,405
Cleveland	14,620	14,620
Richmond	48,460	18,460
Atlanta	43,380	13,380
Chicago	1,720,345	255,595
St. Louis	62,000	34,000
Minneapolis	14,250	14,250
Kansas City	39,830	33,175
Dallas	16,370	9,620
San Francisco	2,572,220	355,470
Treasury	175,200	175,200
TOTALS	$29,535,935	$9,257,780
Type		
Competitive	$26,609,990	$6,331,835
Noncompetitive	600,945	600,945
Subtotal, Public	$27,210,935	$6,932,780
Federal Reserve	2,200,000	2,200,000
Foreign Official Institutions	125,000	125,000
TOTALS	$29,535,935	$9,257,780

An additional $450,000 thousand of the bills will be issued to foreign official institutions for new cash.

B-539

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

FOR IMMEDIATE RELEASE April 11, 1986

FEDERAL FINANCING BANK ACTIVITY

Francis X. Cavanaugh, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of February 1986.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $153.4 billion on February 28, 1986, posting a decrease of $0.3 billion from the level on January 31, 1986. This net change was the result of decreases in holdings of agency debt of less than $0.1 billion and of agency assets of $0.6 billion and an increase in holdings of agency-guaranteed debt of $0.3 billion. FFB made 233 disbursements during February.

Attached to this release are tables presenting FFB February loan activity, commitments entered during February, and FFB holdings as of February 28, 1986.

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B-540

FEDERAL FINANCING BANK

FEBRUARY 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 #569	2/3	$ 293,000,000.00	2/10/86	7.315%	
Advance #570	2/6	306,000,000.00	2/13/86	7.365%	
Advance #571	2/10	298,000,000.00	2/17/86	7.565%	
Advance #572	2/13	51,000,000.00	2/18/86	7.465%	
Advance #573	2/13	243,000,000.00	2/19/86	7.465%	
Advance #574	2/17	167,000,000.00	2/21/86	7.365%	
Advance #575	2/17	150,000,000.00	2/24/86	7.365%	
Advance #576	2/19	229,000,000.00	2/24/86	7.365%	
Advance #577	2/21	146,000,000.00	2/28/86	7.465%	
Advance #578	2/24	35,000,000.00	3/1/86	7.325%	
Advance #579	2/24	25,000,000.00	3/3/86	7.325%	
Advance #580	2/24	284,000,000.00	3/4/86	7.325%	
Advance #581	2/28	279,000,000.00	3/6/86	7.385%	
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #384	2/4	15,000,000.00	5/6/86	7.355%	
+Note #385	2/11	9,244,000.00	5/13/86	7.565%	
Note #386	2/12	405,000.00	5/13/86	7.465%	
+Note #387	2/19	30,415,000.00	5/21/86	7.375%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Botswana 4	2/3	12,500.00	7/25/92	8.105%	
Dominican Republic #8	2/3	200,000.00	4/30/96	8.639%	
Egypt 6	2/3	7,270,222.92	4/15/14	9.485%	
Greece 15	2/3	1,333,480.38	6/15/12	9.423%	
Portugal 1	2/3	742,415.00	9/10/94	9.135%	
Portugal 2	2/3	23,400,000.00	9/10/95	8.858%	
Turkey 18	2/3	823,473.36	3/12/14	9.265%	
Spain 8	2/4	868,342.53	3/25/96	8.435%	
Turkey 18	2/4	856,352.68	3/12/14	9.195%	
Botswana 2	2/5	5,923.76	1/15/88	7.495%	
Egypt 7	2/5	20,202,771.85	7/31/14	9.415%	
Greece 14	2/5	620,884.70	4/30/11	9.435%	
Morocco 13	2/5	8,386.50	5/31/96	8.705%	
Egypt 7	2/6	50,000,000.00	7/31/14	9.453%	
Greece 14	2/7	15,390.60	4/30/11	9.525%	
Indonesia 10	2/7	605,321.00	3/20/93	8.675%	
Portugal 2	2/7	2,690,045.00	9/10/95	9.056%	
Indonesia 10	2/10	2,888,689.32	3/20/93	8.888%	
Turkey 18	2/10	626,074.13	3/12/14	9.285%	
Egypt 7	2/10	1,854,476.98	7/31/14	9.515%	
Indonesia 10	2/10	14,279,076.00	9/10/95	8.723%	
Dominican Republic 8	2/12	1,433,817.62	4/30/96	8.902%	
Morocco 13	2/12	35,130.97	5/31/96	8.735%	
Thailand 12	2/12	128,358.00	3/20/96	8.945%	
Turkey 18	2/12	7,609.00	3/12/14	9.105%	
Egypt 7	2/13	1,856,072.11	7/31/14	9.315%	
El Salvador 7	2/13	334,538.70	6/10/96	9.055%	
Jordan 11	2/13	423,612.80	11/15/92	8.515%	
Morocco 12	2/13	16,960.00	9/21/95	8.975%	
Zaire 4	2/19	299,265.60	9/14/95	8.259%	
Turkey 18	2/19	29,463,893.42	3/12/14	8.836%	

+rollover

FEDERAL FINANCING BANK

FEBRUARY 1986 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual	INTEREST RATE (other than semi-annual)
Foreign Military Sales (Cont'd)					
Egypt 7	2/19	$ 2,595,339.66	7/31/14	9.046%	
Egypt 6	2/24	46,500.00	4/15/14	8.885%	
Jordan 11	2/24	36,997.74	11/15/92	8.285%	
Turkey 18	2/24	3,734,513.67	3/12/14	8.700%	
Egypt 7	2/26	9,045,211.36	7/31/14	8.745%	
Botswana 4	2/27	670,221.28	7/25/92	8.051%	
Philippines 10	2/27	175,586.00	7/15/92	8.275%	
Egypt 7	2/28	1,312,715.00	7/31/14	8.455%	
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
Atlanta, GA	2/3	2,600,000.00	2/3/92	8.560%	8.743% ann.
Indianapolis, IN	2/3	668,500.00	5/1/90	8.515%	8.696% ann.
Peoria, IL	2/3	5,945,000.00	2/1/91	8.535%	8.717% ann.
*Janesville, WI	2/3	393,345.00	2/3/92	8.560%	8.743% ann.
Indianapolis, IN	2/3	6,180,000.00	3/3/86	7.315%	
San Diego, CA	2/6	1,677,900.00	8/1/86	7.555%	
Chicago, IL	2/12	150,000.00	8/16/04	9.205%	9.417% ann.
Louisville, KY	2/12	674,000.00	2/2/87	7.805%	7.953% ann.
Newport News, VA	2/13	132,300.00	2/18/86	7.465%	
South Bend, IN	2/18	322,371.91	2/18/92	8.351%	8.525% ann.
*Seaside, CA	2/18	833,700.00	2/18/92	8.351%	8.525% ann.
+St. Louis, MO	2/18	13,000,000.00	2/15/87	7.725%	7.874% ann.
*Newport News, VA	2/18	2,151,885.00	2/18/92	8.351%	8.525% ann.
Mayaguez, PR	2/20	3,073.18	8/1/86	7.605%	
Santa Ana, CA	2/24	255,000.00	8/15/86	7.535%	
Masillon, OH	2/26	80,000.00	9/15/86	7.575%	7.602% ann.
Montgomery County, PA	2/26	837,000.00	5/15/87	7.785%	7.937% ann.
Springfield, MA	2/26	212,000.00	8/1/86	7.525%	
Boston, MA	2/28	113,163.20	3/3/86	7.385%	
DEPARTMENT OF THE NAVY					
Ship Lease Financing					
Matthiesen	2/18	43,583,218.74	2/28/86	7.365%	
+Matthiesen	2/28	43,583,218.74	4/15/86	7.385%	
Defense Production Act					
Gila River Indian Community	2/24	151,797.40	10/1/92	8.317%	8.232% qtr.
RURAL ELECTRIFICATION ADMINISTRATION					
Saluda River Electric #271	2/3	1,610,000.00	1/2/18	9.494%	9.384% qtr.
*French Broad Electric #245	2/3	1,000,000.00	2/3/88	8.115%	8.034% qtr.
*Saluda River Electric #186	2/3	960,000.00	1/3/17	9.484%	9.374% qtr.
*United Power #139	2/3	3,010,000.00	1/3/17	9.484%	9.374% qtr.
*South Texas Electric #200	2/3	422,000.00	1/3/17	9.484%	9.374% qtr.
*Tex-La Electric #208	2/3	750,000.00	12/31/18	9.485%	9.375% qtr.
Colorado Ute Electric #276	2/4	1,494,000.00	3/31/88	8.152%	8.071% qtr.
New Hampshire Electric #192	2/5	15,815,000.00	1/3/17	9.357%	9.250% qtr.
Hoosier Energy #202	2/6	3,000,000.00	12/31/20	9.418%	9.310% qtr.
*Tennessee Telephone #80	2/6	1,217,000.00	2/6/88	8.115%	8.034% qtr.
New Hampshire Electric #270	2/10	286,000.00	3/31/88	8.305%	8.221% qtr.
*Wabash Valley Power #104	2/10	4,062,000.00	2/10/88	8.275%	8.191% qtr.
*Wabash Valley Power #206	2/10	821,000.00	2/10/88	8.275%	8.191% qtr.
*Wabash Valley Power #206	2/10	1,981,000.00	2/10/88	8.275%	8.191% qtr.
*Wolverine Power #101	2/10	89,000.00	3/31/88	8.299%	8.215% qtr.
*Wolverine Power #182	2/10	3,497,000.00	1/3/17	9.511%	9.401% qtr.

*maturity extension
+rollover

FEDERAL FINANCING BANK

FEBRUARY 1986 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
*Wolverine Power #183	2/10	$ 4,458,000.00	1/3/17	9.511%	9.401% qtr.
*Western Farmers Electric #64	2/10	88,000.00	1/3/17	9.511%	9.401% qtr.
*Western Farmers Electric #133	2/10	8,500,000.00	1/3/17	9.511%	9.401% qtr.
*Western Farmers Electric #220	2/10	2,193,000.00	1/3/17	9.511%	9.401% qtr.
*Soyland Power #165	2/10	980,000.00	1/3/17	9.511%	9.401% qtr.
*Sunflower Electric #174	2/10	7,900,000.00	12/31/18	9.502%	9.392% qtr.
KEPCO #313	2/13	1,485,000.00	12/31/15	9.312%	9.206% qtr.
*South Texas Electric #109	2/13	2,000,000.00	1/3/17	9.317%	9.211% qtr.
*Wolverine Power #101	2/13	1,438,000.00	3/31/88	8.219%	8.136% qtr.
Buckeye Power #314	2/14	11,450,000.00	12/31/15	9.257%	9.152% qtr.
*Sunflower Electric #151	2/18	8,000,000.00	12/31/14	9.079%	8.978% qtr.
*Brazos Electric #230	2/18	2,257,000.00	12/31/18	9.077%	8.976% qtr.
*Dairyland Power #160	2/18	562,000.00	2/18/88	8.115%	8.034% qtr.
*Dairyland Power #173	2/18	557,000.00	2/18/88	8.115%	8.034% qtr.
*Colorado Ute Electric #198	2/18	540,000.00	2/18/88	8.115%	8.034% qtr.
*New Hampshire Electric #192	2/18	970,000.00	2/18/88	8.115%	8.034% qtr.
*Basin Electric #137	2/18	25,000,000.00	12/31/16	9.078%	8.977% qtr.
*East Kentucky Power #140	2/18	506,000.00	12/31/16	9.078%	8.977% qtr.
Tel. Ut. of E. Oregon #256	2/19	466,000.00	12/31/20	9.037%	8.937% qtr.
Oglethorpe Power #246	2/20	28,871,000.00	12/31/20	9.076%	8.975% qtr.
*Colorado Ute Electric #96	2/21	873,000.00	2/22/88	8.175%	8.093% qtr.
*Dairyland Power #54	2/21	1,154,000.00	2/21/89	8.295%	8.211% qtr.
*East Kentucky Power #188	2/21	6,181,000.00	1/3/17	9.044%	8.944% qtr.
*Colorado Ute Electric #96	2/24	745,000.00	2/24/88	8.055%	7.975% qtr.
*Colorado Ute Electric #168	2/24	1,299,057.00	2/24/88	8.055%	7.975% qtr.
*Colorado Ute Electric #203	2/24	1,505,000.00	2/24/88	8.055%	7.975% qtr.
*Central Electric #131	2/24	300,000.00	12/31/16	8.876%	8.780% qtr.
*Western Illinois Power #162	2/24	1,150,000.00	12/31/16	8.876%	8.780% qtr.
New Hampshire Electric #270	2/25	414,000.00	3/31/88	8.005%	7.926% qtr.
*Plains Electric #158	2/27	6,459,000.00	12/31/14	8.673%	8.581% qtr.
*Plains Electric #158	2/27	3,517,000.00	12/31/16	8.674%	8.582% qtr.
*Plains Electric #158	2/27	13,511,000.00	12/31/16	8.674%	8.582% qtr.
*Cooperative Power #130	2/27	8,604,000.00	3/31/88	8.014%	7.935% qtr.
*Cooperative Power #156	2/27	2,396,000.00	2/29/88	8.005%	7.926% qtr.
New Hampshire Electric #270	2/27	1,120,000.00	2/31/88	8.015%	7.936% qtr.
North Carolina Electric #268	2/27	3,420,000.00	1/2/18	8.672%	8.580% qtr.
United Power #86	2/27	600,000.00	12/31/14	8.673%	8.581% qtr.
*Allegheny Electric #175	2/28	2,660,000.00	12/31/15	8.386%	8.300% qtr.
*Allegheny Electric #175	2/28	2,973,000.00	12/31/15	8.386%	8.300% qtr.
*Tri-State G&T #79	2/28	5,092,000.00	12/31/18	8.443%	8.356% qtr.
*Tri-State G&T #177	2/28	28,000.00	12/31/18	8.443%	8.356% qtr.
*Southern Illinois Power #38	2/28	500,000.00	3/31/88	7.851%	7.775% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
Columbus Countywide Dev. Corp.	2/5	52,000.00	2/1/01	9.131%	
Ashtabula County 503 Corp.	2/5	55,000.00	2/1/01	9.131%	
Southern Nevada CDC	2/5	65,000.00	2/1/01	9.131%	
Ashtabula County 503 Corp.	2/5	84,000.00	2/1/01	9.131%	
Middle Flint Area Dev. Corp.	2/5	85,000.00	2/1/01	9.131%	
Central Virginia Ec. Dev. Corp.	2/5	97,000.00	2/1/01	9.131%	
Iowa Business Growth Co.	2/5	105,000.00	2/1/01	9.131%	
Rural Missouri, Inc.	2/5	119,000.00	2/1/01	9.131%	
Pennyrile Area Dev. Dist., Inc.	2/5	132,000.00	2/1/01	9.131%	
San Diego County LDC	2/5	138,000.00	2/1/01	9.131%	
Dev. Corp. of Middle Georgia	2/5	160,000.00	2/1/01	9.131%	
San Diego County LDC	2/5	162,000.00	2/1/01	9.131%	
Coastal Enterprises, Inc.	2/5	295,000.00	2/1/01	9.131%	

+rollover
*maturity extension

FEDERAL FINANCING BANK

FEBRUARY 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 Employment Dev. Co.	2/5	$ 357,000.00	2/1/01	9.131%	
Brattleboro Dev. Credit Corp.	2/5	378,000.00	2/1/01	9.131%	
McPherson County SBD Assoc.	2/5	34,000.00	2/1/06	9.323%	
St. Louis County LDC	2/5	34,000.00	2/1/06	9.323%	
Tucson LDC	2/5	45,000.00	2/1/06	9.323%	
Tulare County Ec. Dev. Corp.	2/5	61,000.00	2/1/06	9.323%	
St. Louis County LDC	2/5	62,000.00	2/1/06	9.323%	
CDC of Mississippi, Inc.	2/5	66,000.00	2/1/06	9.323%	
Texas CDC, Inc.	2/5	69,000.00	2/1/06	9.323%	
Verd-Ark-CA Dev. Corp.	2/5	73,000.00	2/1/06	9.323%	
Birmingham Citywide LDC	2/5	93,000.00	2/1/06	9.323%	
Chester County SB Asst. Corp.	2/5	95,000.00	2/1/06	9.323%	
St. Louis County LDC	2/5	98,000.00	2/1/06	9.323%	
Tulare County Ec. Dev. Corp.	2/5	103,000.00	2/1/06	9.323%	
Jefferson County LDC	2/5	105,000.00	2/1/06	9.323%	
Old Colorado City Dev. Co.	2/5	105,000.00	2/1/06	9.323%	
Cleveland Area Dev. Fin. Corp.	2/5	108,000.00	2/1/06	9.323%	
Gr. Metro. Chicago Dev. Corp.	2/5	121,000.00	2/1/06	9.323%	
Fargo-Cass County. Ind. D.C.	2/5	122,000.00	2/1/06	9.323%	
Nine County Dev., Inc.	2/5	126,000.00	2/1/06	9.323%	
South Eastern Ec. Dev. Corp.	2/5	134,000.00	2/1/06	9.323%	
Evergreen Community Dev. Assoc.	2/5	145,000.00	2/1/06	9.323%	
South Shore Ec. Dev. Corp.	2/5	145,000.00	2/1/06	9.323%	
Gr. Salt Lake Bus. District	2/5	147,000.00	2/1/06	9.323%	
Charlotte CDC	2/5	160,000.00	2/1/06	9.323%	
Tulare County Ec. Dev. Corp.	2/5	173,000.00	2/1/06	9.323%	
Centralina Dev. Corp.	2/5	182,000.00	2/1/06	9.323%	
Lake County Ec. Dev. Corp.	2/5	184,000.00	2/1/06	9.323%	
Columbus Countywide Dev. Corp.	2/5	187,000.00	2/1/06	9.323%	
Tulare County Ec. Dev. Corp.	2/5	193,000.00	2/1/06	9.323%	
Long Island Dev. Corp.	2/5	207,000.00	2/1/06	9.323%	
Lorain County CDC	2/5	210,000.00	2/1/06	9.323%	
CDC of Mississippi, Inc.	2/5	216,000.00	2/1/06	9.323%	
Granite State Ec. Dev. Corp.	2/5	239,000.00	2/1/06	9.323%	
Northwest Arkansas CDC	2/5	254,000.00	2/1/06	9.323%	
Northwest Arkansas CDC	2/5	279,000.00	2/1/06	9.323%	
Nevada State Dev. Corp.	2/5	285,000.00	2/1/06	9.323%	
Northeast Louisiana Ind., Inc.	2/5	286,000.00	2/1/06	9.323%	
Ohio Statewide Dev. Corp.	2/5	289,000.00	2/1/06	9.323%	
Indiana Statewide CDC	2/5	295,000.00	2/1/06	9.323%	
CDC of N.E. Georgia, Inc.	2/5	320,000.00	2/1/06	9.323%	
Long Island Dev. Corp.	2/5	320,000.00	2/1/06	9.323%	
Nevada State Dev. Corp.	2/5	328,000.00	2/1/06	9.323%	
Wisconsin Bus. Dev. Fin. Corp.	2/5	336,000.00	2/1/06	9.323%	
Asheville-Buncombe Dev. Corp.	2/5	369,000.00	2/1/06	9.323%	
Evergreen Community Dev. Assoc.	2/5	378,000.00	2/1/06	9.323%	
Ocean State B.D.A., Inc.	2/5	420,000.00	2/1/06	9.323%	
Neuse River Dev. Auth., Inc.	2/5	500,000.00	2/1/06	9.323%	
MSP 503 Dev. Corp.	2/5	53,000.00	2/1/11	9.414%	
Wilmington Indus. Dev. Inc.	2/5	58,000.00	2/1/11	9.414%	
Texas Panhandle Reg. Dev. Corp.	2/5	61,000.00	2/1/11	9.414%	
Gr. Southwest Kansas CDC	2/5	67,000.00	2/1/11	9.414%	
New Haven Comm. Invest. Corp.	2/5	84,000.00	2/1/11	9.414%	
San Diego County LDC	2/5	116,000.00	2/1/11	9.414%	
Neuse River Dev. Auth., Inc.	2/5	126,000.00	2/1/11	9.414%	
Arrowhead Reg. Dev. Corp.	2/5	133,000.00	2/1/11	9.414%	
St. Louis County LDC	2/5	135,000.00	2/1/11	9.414%	
E.C.I.A. Bus. Growth, Inc.	2/5	139,000.00	2/1/11	9.414%	
Wilmington Indus. Dev., Inc.	2/5	142,000.00	2/1/11	9.414%	
Mentor Ec. Assistance Corp.	2/5	147,000.00	2/1/11	9.414%	
Treasure Valley C.D. Corp.	2/5	147,000.00	2/1/11	9.414%	
St. Paul 503 Dev. Co.	2/5	168,000.00	2/1/11	9.414%	
Union County EDC of Sacramento	2/5	207,000.00	2/1/11	9.414%	

FEDERAL FINANCING BANK

FEBRUARY 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)					
San Francisco Indus. Dev. Fund	2/5	$ 212,000.00	2/1/11	9.414%	
Clay County Dev. Corp.	2/5	218,000.00	2/1/11	9.414%	
Amador Ec. Dev. Corp.	2/5	227,000.00	2/1/11	9.414%	
Treasure Valley CDC	2/5	231,000.00	2/1/11	9.414%	
La Habra LDC, Inc.	2/5	246,000.00	2/1/11	9.414%	
Warren Redev. & Planning Corp.	2/5	268,000.00	2/1/11	9.414%	
Ocean State Bus. D.A., Inc.	2/5	353,000.00	2/1/11	9.414%	
San Diego County LDC	2/5	360,000.00	2/1/11	9.414%	
Small Business Investment Company Debentures					
First Princeton Capital Corp.	2/19	500,000.00	2/1/93	8.655%	
Associated Capital Corporation	2/19	500,000.00	2/1/93	8.655%	
ASEA Harvest Partners II	2/19	1,000,000.00	2/1/96	8.795%	
Clinton Capital Corporation	2/19	4,200,000.00	2/1/96	8.795%	
Fundex Capital Corporation	2/19	480,000.00	2/1/96	8.795%	
GC&H Parnters	2/19	300,000.00	2/1/96	8.795%	
Questech Capital Corporation	2/19	2,000,000.00	2/1/96	8.795%	
Rocky Mountain Ventures Ltd.	2/19	1,000,000.00	2/1/96	8.795%	
Associated Capital Corporation	2/19	500,000.00	2/1/96	8.795%	
Threshold Ventures Inc.	2/19	500,000.00	2/1/96	8.795%	
Shared Ventures Inc.	2/19	400,000.00	2/1/96	8.795%	
S.W. Venture Cap. of Texas Inc.	2/19	500,000.00	2/1/96	8.795%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
+Note A-86-06	2/28	619,327,813.54	5/30/86	7.425%	

+rollover

FEDERAL FINANCING BANK
FEBRUARY 1986 Commitments

BORROWER	GUARANTOR	AMOUNT	COMMITMENT EXPIRES	MATURITY
Bethlehem, PA	HUD	$ 633,000.00	2/15/87	2/15/87
Lorain, OH	HUD	700,000.00	9/1/86	9/1/86
Miami, FL	HUD	5,958,400.00	8/1/87	8/1/87
Pasadena, CA	HUD	178,246.17	7/15/86	7/15/86
Sacramento, CA	HUD	750,000.00	2/15/87	2/15/87
Sacramento, CA	HUD	805,302.00	2/15/87	2/15/87
St. Louis, MO	HUD	15,000,000.00	2/15/87	2/15/87
Cajun Electric Power	REA	200,000,000.00	2/24/90	12/31/20
Kodiak Electric Association	REA	1,603,000.00	3/31/93	12/31/20

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	February 28, 1986	January 31, 1986	Net Change 2/1/86-2/28/86	Net Change--FY 1986 10/1/85-2/28/86
Agency Debt				
Export-Import Bank	$ 15,670.3	$ 15,670.3	$ -0-	$ 261.3
NCUA-Central Liquidity Facility	225.8	225.2	0.7	3.7
Tennessee Valley Authority	14,673.0	14,690.0	-17.0	292.0
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	63,774.0	64,354.0	-580.0	-395.0
DHHS-Health Maintenance Org.	105.9	105.9	-0-	-3.3
DHHS-Medical Facilities	122.1	122.1	-0-	-0.7
Overseas Private Investment Corp.	3.4	3.4	-0-	-2.7
Rural Electrification Admin.-CBO	3,724.3	3,724.3	-0-	-0-
Small Business Administration	30.0	30.5	-0.5	-2.9
Government-Guaranteed Lending				
DOD-Foreign Military Sales	18,542.4	18,391.3	151.1	453.8
DEd.-Student Loan Marketing Assn.	5,000.0	5,000.0	-0-	-0-
DHUD-Community Dev. Block Grant	288.7	281.1	7.6	-0.7
DHUD-New Communities	32.2	32.2	-0-	-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	27.8	-0-	-0.4
NASA-Space Communications Co.	887.6	887.6	-0-	-0-
DON-Ship Lease Financing	1,469.6	1,426.0	43.6	156.5
DON-Defense Production Act	7.3	7.1	0.2	1.5
Oregon Veteran's Housing	60.0	60.0	-0-	-0-
Rural Electrification Admin.	20,739.0	20,677.5	61.5	-936.5
SBA-Small Business Investment Cos.	1,059.8	1,050.2	9.6	35.9
SBA-State/Local Development Cos.	688.5	674.7	13.8	92.8
TVA-Seven States Energy Corp.	1,728.5	1,709.8	18.7	77.1
DOT-Section 511	65.6	65.7	-0-	-88.0
DOT-WMATA	177.0	177.0	-0-	-0-
TOTALS*	$ 153,418.4	$ 153,709.3	$ -290.9	$ -94.8

*figures may not total due to rounding

TREASURY NEWS

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

For Immediate Release
April 11, 1986

Contact: Charlie Powers
566-5252

TREASURY DEPARTMENT ASSESSES PENALTY AGAINST INTERFIRST CORPORATION UNDER BANK SECRECY ACT

The Department of the Treasury announced today that InterFirst Corporation, a bank holding company headquartered in Dallas, Texas, has agreed to a settlement that requires the bank to pay a civil penalty of $315,000 for failure to report 1,261 currency transactions as required by the Bank Secrecy Act.

Francis A. Keating, II, Assistant Secretary (Enforcement), who announced the penalty, said the penalty represented a complete settlement of InterFirst's civil liability for these violations. Keating said InterFirst cooperated fully with Treasury. This cooperation and InterFirst's history of assistance to law enforcement authorities were considered in assessing the amount of the penalty. InterFirst has instituted measures to ensure future compliance with the Bank Secrecy Act throughout its system.

The Department of the Treasury has no evidence that InterFirst engaged in any criminal activities in connection with these reporting violations.

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B-541

TREASURY NEWS

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

FOR IMMEDIATE RELEASE ROOM 5310 April 14, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,016 million of 13-week bills and for $7,033 million of 26-week bills, both to be issued on April 17, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 17, 1986			:	26-week bills maturing October 16, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	5.83%a/	6.00%	98.526	:	5.90%	6.17%	97.017
High	5.85%	6.02%	98.521	:	5.93%	6.20%	97.002
Average	5.84%	6.01%	98.524	:	5.93%	6.20%	97.002

a/ Excepting 1 tender of $1,035,000.

Tenders at the high discount rate for the 13-week bills were allotted 15%.
Tenders at the high discount rate for the 26-week bills were allotted 58%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 52,300	$ 52,300	:	$ 33,675	$ 32,175
New York	22,744,260	5,784,260	:	22,987,250	5,545,350
Philadelphia	30,695	30,695	:	25,485	25,485
Cleveland	105,740	54,435	:	29,695	29,695
Richmond	54,440	44,440	:	140,770	103,170
Atlanta	59,810	40,360	:	53,230	38,450
Chicago	2,377,615	386,690	:	1,837,685	324,525
St. Louis	76,580	46,880	:	78,060	50,060
Minneapolis	42,805	17,455	:	44,085	31,485
Kansas City	67,690	67,190	:	39,450	38,950
Dallas	50,645	41,395	:	32,515	25,415
San Francisco	1,835,550	84,200	:	1,605,570	370,150
Treasury	365,580	365,580	:	417,945	417,945
TOTALS	$ 27,863,710	$7,015,880	:	$27,325,415	$7,032,855
Type					
Competitive	$ 24,625,370	$3,777,540	:	$23,814,915	$3,522,355
Noncompetitive	1,183,710	1,183,710	:	956,600	956,600
Subtotal, Public	$ 25,809,080	$4,961,250	:	$24,771,515	$4,478,955
Federal Reserve	1,695,830	1,695,830	:	1,650,000	1,650,000
Foreign Official Institutions	358,800	358,800	:	903,900	903,900
TOTALS	$ 27,863,710	$7,015,880	:	$27,325,415	$7,032,855

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. ROOM 5310 April 15, 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 April 24, 1986. This offering will result in a paydown for the Treasury of about $200 million, as the maturing bills are outstanding in the amount of $14,194 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, April 21, 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 January 23, 1986, and to mature July 24, 1986 (CUSIP No. 912794 KX 1), currently outstanding in the amount of $7,238 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,000 million, to be dated April 24, 1986, and to mature October 23, 1986 (CUSIP No. 912794 LH 5).

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 April 24, 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 $840 million as agents for foreign and international monetary authorities, and $3,258 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).

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

For Immediate Release

April 15, 1986

Contact: Bob Levine

(202) 566 2041

STATEMENT ON ECUADOR

The United States Government has assured the Government of Ecuador of its support for Ecuador's continuing economic adjustment efforts. The United States praises these efforts particularly in light of the recent difficulties stemming from the oil price drop. In this connection, the Treasury Department is actively considering, in consultation with the appropriate Ecuadorian authorities, provision of additional short-term financing to strengthen Ecuador's financial position.

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

STATEMENT OF THE HONORABLE JAMES A. BAKER, III
SECRETARY OF THE TREASURY
OF THE UNITED STATES

BEFORE THE OECD MINISTERIAL MEETING
APRIL 17, 1986
PARIS, FRANCE

Assuring Sustained Economic Growth and Adjustment

Mr. Chairman, Secretary General Paye, Distinguished Colleagues.

The Need for Cooperation

One year ago, in different economic circumstances, I suggested that we form a partnership for growth. The principal focus of our discussions then was on economic problems -- sluggish domestic performance, structural barriers to growth and employment creation; and the persistence of large and growing external imbalances.

Today, though conditions have changed, that concept of partnership remains valid. There have been important improvements in the environment and short-run prospects for many weaker economies, but we still need to act together -- cooperatively and effectively -- to take full advantage of our improved opportunities.

- We can say with the advantage of hindsight that when we last met, the dollar -- and, in mirror-image, the major non-dollar currencies -- had reached and passed a major turning point. From the peak of late February last year, the dollar has declined 22 percent on a trade-weighted basis against the other major currencies. Against the Yen and the DM the dollar has declined 31 and 33 percent, respectively.

- The dramatic decline in oil prices is a second major change in the environment. We believe that it is, on balance, overwhelmingly favorable to the world economy, and to the adjustment of external imbalances.

- We hear of renewed dynamism in Europe, and of Japanese efforts to stimulate domestic demand.

In the remainder of my remarks, I want to suggest ways in which we can best take advantage of these developments to improve prospects for growth and adjustment of external imbalances. Let me turn first to oil prices.

The effect of lower oil prices is highly favorable; it really has a double-barreled effect, on external imbalances as well as domestic performance.

- o The direct effect lowers substantially the import bill of most industrial and developing countries; the U.S. import bill should fall by about $18 billion per year.

- o We expect lower oil prices to add up to a point to real GNP growth in Germany in the first year; the rest of Europe should equally benefit, and even the UK will gain in the long run from stronger growth in her major trading partners.

- o We expect OECD inflation to be cut by up to two points and Germany and Japan could experience zero or even negative inflation rates.

The latest round of discount rate cuts reinforces the favorable effects of lower oil prices; in addition to demonstrating the benefits of sustained anti-inflation policies, it illustrates the importance of cooperative action.

The U.S. is doing its share. Specifically, we are expecting strong growth, cutting government spending and reducing our budget deficit, and seeking pro-growth tax reform. Let me now turn to the U.S. economy.

U.S. Domestic Economic Outlook

The U.S. economy is now in its fourth year of expansion. Strong real growth and moderate inflation are projected for 1986 and beyond.

We expect 4 percent real growth from fourth quarter 1985 to fourth quarter 1986, reflecting strong residential investment activity plus a rebuilding of inventories. Consumption and capital investment should rise moderately.

The slowdown in U.S. real growth, to just under 2 percent average annual rate in the last year and one half, was largely an inventory phenomenon. Total domestic final demand has remained strong. We expect this underlying strength to continue, while inventory investment picks up some. The expected flattening out of net exports in real terms will also contribute to GNP growth in the short term. Falling oil prices and other favorable developments are causing upward revision of many private forecasts.

- Short-term interest rates are down by about 2 percentage points and long-term rates by 3-4 percentage points in the last year. This should help to stimulate interest-sensitive sectors of the economy.

- U.S. stock and bond markets have been rallying strongly during much of this year, reflecting increasing optimism over the economic and financial outlook.

- Inflation remains subdued. A disinflationary process is still underway in energy, agriculture and other sectors of the economy. Money wages are rising slowly and there are few signs of any emerging inflationary pressures.

On the fiscal policy front, we are taking meaningful action to cut the budget deficits. As you know, the Gramm-Rudman-Hollings Act provides a mechanism for reducing Federal spending and the deficit, and is designed to produce a balanced budget by 1991.

The President's FY 1987 budget, announced on February 5, meets or exceeds the GRH targets. In FY 1987, the budget deficit would be reduced to $144 billion (3.2 percent of GNP). The deficit would continue to be reduced steadily under GRH, falling below 1 percent of GNP by 1990 and reaching balance by 1991.

Outlays would continue to grow in absolute terms along the path projected in the new budget, but the rate of advance would be reduced significantly. Federal outlays would decline steadily as a ratio to GNP from 24 percent in 1985 to below 19 percent in 1991. Receipts would grow strongly as the economy itself grew, but receipts would remain close to a 19 percent ratio to GNP -- slightly above historical experience.

The only alternatives to domestic spending cuts along the lines indicated in the President's budget are to raise taxes, to lower defense spending, or to cut social security benefits, none of which is acceptable. President Reagan has made control of the size of government, to release needed resources to the private sector, an urgent national priority. He also retains his firm commitment to continuing tax reform to remove disincentives to effort and efficiency, and to keeping inflation under control.

I might note that we are hearing expressions of concern that success in the U.S. effort to reduce federal outlays and our budget deficit will be bad for the global economy, since it would cause a slowdown in U.S. growth. This seems ironic, in view of the volume of complaints about large U.S. deficits before we took this action.

We believe such concerns are ill-founded, and our growth forecast includes the effects of Gramm-Rudman in reducing our budget deficit. The favorable factors I have cited, notably lower oil prices and substantial interest rate declines, will mean that the private sector quickly takes up any slack due to deficit reduction.

The External Situation

Exchange rate changes over the past year, and lower oil prices, should produce a substantial reduction in the projected U.S. trade and current account deficits from what they would have been, though they will remain at politically unsustainable levels.

Reflecting the lower dollar, improved foreign growth prospects, and lower oil prices, we now believe the U.S. trade deficit will gradually improve this year and in 1987.

- o For 1986, we now project a trade deficit of about $125 billion -- $20 billion lower than we projected last fall -- and a current account deficit about $120 billion.

- o We expect a further substantial decline in trade and current account deficits, to below $100 billion, for 1987.

This outlook is heavily dependent on assumptions as to growth rates at home and abroad, as well as the changes in exchange rates which have occurred over the past year. In particular, we expect growth in the other major industrial countries to strengthen relative to the U.S., thus closing the "growth gap" which has been a major factor in the strong dollar and widening U.S. external deficits.

- o Exchange rate changes to date, along with lower oil prices, are the major factor in the projected reversal of the U.S. trade and current account deficits.

- o But by late 1987 the exchange rate movements to date will have taken their full effect, and the "growth gap" will reassert itself, causing our trade and current account deficits to widen even further.

The 1987 level itself -- in the $100 billion range -- is not politically sustainable.

I must tell you frankly that protectionism in the U.S. is not dead. Our ability to resist a resurgence is seriously weakened if we cannot hold out the realistic prospect of sustained adjustment in the U.S. external deficit in future years, well beyond the improvement now projected for 1986 and 1987. And I might add that our efforts to hold the line are not helped when the EC imposes GATT-illegal restrictions to limit our agricultural sales to Portugal.

Basically, there are only two fundamental ways the U.S. imbalance can be reduced to sustainable levels over time:

- o By reversing the "growth gap" between the U.S. and our trading partners -- both in the OECD and in the LDCs; or

- o Through further changes in relative cost and price performance, including exchange rate change.

We all agree that U.S. recession is not the way to alter relative growth performance. Fortunately a recession is not in our forecast, nor in our policies.

<u>The Need for Stronger Growth Abroad</u>

Recent experience shows the importance of exchange rates as powerful adjustment tools, and sensitive indicators of developments in fundamentals of policies and performance. We recognize that changing fundamentals takes place over time; the effects show up only gradually. But current trends and prospects suggest a need for greater emphasis on achieving more balanced growth across countries without cutting U.S. growth, and for less exclusive reliance on exchange rate change in achieving more sustainable pattern of external balances.

Recently, we have been hearing increasing optimism about the growth outlook for other OECD countries. But the projected improvements to date do little more than keep pace with the U.S. outlook for 1986 and 1987. <u>And</u> substantial external imbalances will persist -- particularly in Japan and Germany. For adjustment to be sustained, we need stronger European and Japanese growth to help reduce trade and current account imbalances further.

We believe that sharply lower oil prices do not alter this goal; rather, potential growth effects make it more achievable.

<u>Growth, Adjustment, and Oil Prices</u>

Oil price declines, both in their magnitude and timing -- since they coincide with signs of independent European recovery -- offer a golden opportunity to strengthen growth. Stronger growth not only helps intra-OECD adjustment, but is key (along with lower interest rates) to the LDC debt strategy.

This leaves one basic question that is crucial to the outlook: how can the other OECD countries take advantage of oil price declines to contribute to adjustment of external imbalances -- not simply strengthening <u>all</u> current accounts, but improving the <u>pattern</u> of external balances as well.

For Europe, a prerequisite to achieving stronger, more sustained growth continues to be the removal of structural rigidities, which thwart the efficient use of economic resources. These structural barriers are especially troublesome in the labor market, where they depress both the supply of and demand for employment. The labor market rigidities we are concerned with include high minimum wages, government regulations limiting the ability of firms to hire and fire workers, and in some countries excessively generous unemployment and welfare benefits which undermine incentives to seek work. Such rigidities have a direct effect in discouraging growth of employment. But they also have a longer-term impact, through their effect on decisions to invest in labor saving, rather than employment-creating, productive capacity.

Our partners face other structural problems that hinder economic performance, in addition to labor market rigidities. A number of these are the direct result of previous government policy actions: for example, high marginal tax rates that unnecessarily discourage private initiative and work effort, and taxes and regulatory controls which stifle development of dynamic financial markets.

Japan also faces structural barriers to more rapid growth, especially growth of domestic demand which is crucial to adjustment of Japan's large external surplus.

Japan is more dependent on imported energy than any other industrial country. As a result, Japan is in a position to gain relatively more than others in terms of a favorable impact on real domestic growth from lower dollar oil prices. But this occurs only if the gains are fully translated into growth of domestic demand. At the same time, lower oil prices will result in a sizable increase in Japan's current account surplus in 1986 and 1987.

On the other hand, recent exchange rate movements are likely to cost Japan more in weakened trade competitiveness and export stimulus than other countries, and this will have a negative effect on overall real GNP growth. Thus it is extremely important that the growth slowdown from yen appreciation be offset by higher domestic demand from oil price gains and specific policies undertaken to strengthen domestic investment and consumption.

More generally, the OECD needs to persevere with efforts to improve the structure and efficiency of members' capital and financial markets. As part of this process, I am pleased that work is underway to strengthen and extend the OECD Codes of Liberalization of Invisible Operations and Capital Movements to cover the full range of bank and financial market operations.

In addition, we all need to keep our markets open. Stronger growth and exchange rate realignment will be hampered in bringing about adjustment of external imbalances if countries -- especially those in external surplus -- restrict access to their markets to protect inefficient domestic producers.

Finally, we need to provide greater impetus to ongoing efforts to improve the functioning of the international monetary system. The current international monetary system has both strengths and weaknesses. It has provided a useful framework for responding to the multiple global economic shocks of the

1970s and early 1980s. And recent cooperative efforts have helped produce greater convergence of favorable economic performance and more consistent policies among the major industrialized nations. This has contributed to exchange rates which are more in line with fundamentals, helping set the stage for a reduction in large external imbalances.

This progress notwithstanding, the system continues to have weaknesses which need addressing, both in terms of the framework within which our economies relate, as well as in terms of underlying policy and performance weaknesses. The U.S. is committed to work with others in an effort to find the best ways to strengthen the system. We need to improve the functioning of the system, not only to help us deal with the economic problems we face, but to help avoid such problems in the future.

Conclusion

Since we last met, there has been a substantial change for the better in performance and prospects for the world economy. But this does not lessen the nature of the challenge we face, which remains to cooperate more closely to implement policies which will foster sustained noninflationary growth and orderly adjustment of imbalances. Rather, the improved situation raises the potential rewards of success.

Optimism, but not complacency, should be our attitude. We know what needs to be done, and have made good progress in a number of areas during the past year. We have come too far to relax our efforts short of full success.

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April 16, 1986

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DEPARTMENT OF THE TREASURY

J. Roger Mentz
Assistant Secretary of the Treasury for Tax Policy

J. Roger Mentz was confirmed by the U.S. Senate as Assistant Secretary of the Treasury for Tax Policy on April 11, 1986 and was sworn in on April 14. He succeeds Ronald A. Pearlman, who returned to private law practice.

From December 1985 until his confirmation, Mr. Mentz served as Acting Assistant Secretary of the Treasury (Tax Policy). From April to December 1985 he was Deputy Assistant Secretary for Tax Policy at the Department of Treasury. Previously, he was partner in the law firm of Mudge Rose Guthrie Alexander and Ferdon from 1966 to 1985.

Mr. Mentz earned a B.S.E. degree with honors in chemical engineering from Princeton University in 1963. He received his L.L.B. degree from the University of Virginia Law School in 1966, where he served as a member of the Virginia Law Review and was a member of the Order of the Coif.

Mr. Mentz has served on the Executive Committee of the New York State Bar Association Tax Section since 1973 and served as Chairman of the Tax Section from 1982-83. He is also a member of the American Bar Association Section of Taxation. Mr. Mentz was an Adjunct Associate Professor at the New York University Law School L.L.M. Program from 1979-80, where he taught a course in international taxation. He has also written extensively on a variety of tax issues.

Mr. Mentz and his wife Marilyn have two children, Steven and Tanna.

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APR 21 4 17 PM '86

STATEMENT OF THE HONORABLE FRANCIS A. KEATING, II
ASSISTANT SECRETARY (ENFORCEMENT)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 17, 1986

Mr. Chairman and Members of the Committee:

I sincerely appreciate the opportunity to appear before you to discuss legislative responses to the problems of money laundering, especially legislative initiatives that will enhance Treasury's enforcement of the Bank Secrecy Act. This is my first opportunity to testify before Congress on this subject since I assumed the position of Assistant Secretary last December and to affirm to you my commitment to rigorous Bank Secrecy Act enforcement.

I am pleased to introduce Mr. Robert J. Stankey, the Acting Director of the Office of Financial Enforcement, who I know is a familiar figure to you, Mr. Chairman, and your staff. Mr. Stankey has been with Treasury since the inception of the Bank Secrecy Act. It is fair to say that he, more than any other person, has been responsible for the development of the Bank Secrecy Act into an effective law enforcement weapon and cornerstone in Treasury's financial law enforcement program.

Update on Treasury's Bank Secrecy Act Enforcement

Before turning to the legislative measures under discussion, I would like to briefly update the Committee on Treasury's Bank Secrecy Act enforcement activities since my predecessor testified before you last year in your hearings following the Bank of Boston case. On February 14, 1986, we prepared for the Committee a report on these activities which we have made available for distribution today. I will highlight four topics from that report - civil penalty assessment, improved Bank Secrecy Act examination procedures, commitment of Treasury resources to Bank Secrecy Act enforcement and regulatory amendments.

Civil Penalty Assessment

First, I would like to discuss Treasury's imposition of civil penalties against financial institutions for past non-compliance.

In the wake of the publicity surrounding the Bank of Boston case, and in good measure as a response to the hearing of this Committee, over sixty banks or bank holding companies have come forward to Treasury with past violations of the Bank Secrecy Act. Some have come forward as a result of bank regulatory examinations, particularly those of the Comptroller of the Currency. To date, fifteen civil penalties have been assessed under 31 U.S.C. § 5321, ranging from $112,000 to $4.75 million in the case of Bank of America.

Other cases are under review, and we anticipate that additional penalties will be assessed shortly. In many instances, the cases are taking several months to conclude because of the time required for banks to conduct an examination of past compliance and to reconstruct past unreported transactions for late-filing of Currency Transaction Reports.

We want to emphasize that Treasury has not as yet closed the door to volunteers, and we continue to encourage financial institutions to come forward to disclose past violations. Non-volunteer banks will be dealt with more severely. Financial institutions that have not filed required Currency Transaction Reports for any reason have a continuing legal duty to do so. Banks that become aware of past non-compliance and make no effort to contact Treasury are running a serious risk. We are planning a major effort to uncover these non-volunteers. This effort will ultimately depend heavily on the support of the bank supervisory agencies.

We believe that Treasury's rigorous enforcement of the Bank Secrecy Act, including the imposition of publicly announced, substantial civil penalties, where appropriate, has contributed to enhanced awareness of the requirements of the Bank Secrecy Act. As a consequence, and as confirmed in our dealings with many banks and the increased volume of Currency Transaction Reports, we believe that overall compliance has improved and that compliance has become a high priority with many major financial institutions.

Improved Examination Procedures

Another major initiative to ensure full compliance with the Bank Secrecy Act has been Treasury's work with bank supervisory agencies to improve and standardize Bank Secrecy Act examination procedures.

As many of the civil penalty cases and the Bank of Boston case demonstrated, the procedures being used by the examiners were not sufficient to ensure that all violations of the Act would be detected, particularly failures to report international bank-to-bank transactions. These procedures needed to be improved, and a number of other issues also had to be considered in order to make compliance examinations more effective. These issues included the maintenance of detailed workpapers, the sharing of information among bank supervisory agencies, and the uniform application of the examination procedures. To address these matters, we have had a series of meetings with the Federal bank supervisory agencies and others who have an interest in improving the procedures used by examiners for checking the compliance of financial institutions with the Bank Secrecy Act. As a result of these consultations, we expect to send final instructions on examination procedures to the supervisory agencies this week. It is axiomatic that improved and aggressive examination will foster improved compliance.

Our experience in the improvement and standardization of examination procedures made clear to me the need for ongoing interchange of ideas between Treasury and the agencies to which Treasury has delegated Bank Secrecy Act enforcement responsibility. Therefore, I am convening a permanant Interagency Working Group on Bank Secrecy Compliance, consisting of representatives of Treasury, Customs, IRS, the SEC, and the bank supervisory agencies. The group will be chaired by the Deputy Assistant Secretary (Law Enforcement) and will meet monthly or more frequently as needed. We will use this forum to discuss not only examination procedures, but mutual enforcement problems and Treasury policy initiatives including revisions to regulations.

Commitment of Treasury Resources

In July, 1985, the Treasury Department established the Office of Financial Enforcement to assist in implementing and administering the Bank Secrecy Act regulations. The establishment of this office provided a focal point for Bank Secrecy Act related activity within the Treasury Department and acknowledged the increasing importance of the Act in Treasury's law enforcement efforts. The office has broad responsibilities for the compliance activities of all agencies that have been delegated responsibilities under the Act, and there has been an increased commitment of staff resources to the office.

In addition to the increase in the Office of Financial Enforcement, there has been a very large commitment of resources by both the Customs and the IRS. As Assistant Commissioner Wassenaar testified yesterday, the IRS has established a separate division in Detroit to handle BSA reporting matters.

Regulatory Initiatives

Since last year, we have strengthened the Treasury Bank Secrecy Act regulations in several respects. On May 7, 1985, regulations became effective that designated casinos as financial institutions subject to Bank Secrecy Act reporting and recordkeeping requirements. As evidenced in hearings by the President's Commission on Organized Crime last summer, money laundering through casinos may have been even more widespread than once thought. We believe that the new regulations have reduced the attactiveness of the use of casinos for money laundering.

A regulatory amendment pertaining to international transactions was published as a final rule last summer. Under the regulations, Treasury will be able in the future to require a financial institution or a selected group of financial institutions to report specified international transactions, including wire transfers or cashier's checks, for defined periods of time. We envision that this will require reporting of transactions with financial institutions in designated foreign locations that would produce information especially useful in identifying individuals and companies involved in money laundering and tax evasion. The Internal Revenue Service's Office of Criminal Investigations is developing a plan for the initial use of this regulatory authority.

We are also discussing a number of other regulatory amendments, including regulatory solutions to problems of "smurfing" and structuring transactions to avoid the reporting requirements of the Bank Secrecy Act. These revisions are being discussed within Treasury and with the Department of Justice and should be published in the Federal Register within the next few weeks. As with all amendments to the Bank Secrecy regulations, Treasury will consider carefully the financial and operational impact of regulatory changes on financial institutions as it seeks to meet the needs of law enforcement.

Legislation

I would now like to address the various proposals under discussion to bolster our attack against money laundering and to improve Treasury's enforcement of the Bank Secrecy Act.

First is H.R. 2785 and 2786 (identical bills), the "Money Laundering and Related Crimes Act," which was developed jointly by the Departments of Justice and Treasury. I would like to remark on the critical revisions to the Bank Secrecy Act contained in the bill. I understand that my colleague from the Department of Justice, who will testify before you next week, will address the provisions of the bill establishing the criminal offense of money laundering and related revisions to Title 18.

Most important, under H.R. 2785 and 2786 the Secretary would be given for the first time summons authority both for financial institution witnesses and documents in connection with Bank Secrecy Act violations. This authority was among the legislative recommendations in the October, 1984 report of the President's Commission on Organized Crime on money laundering and is also contained in H.R. 1945 and H.R. 1367.

The Secretary may summon a financial institution officer, or an employee, former officer, former employee or custodian of records, who may have knowledge relating to a violation of a recordkeeping or reporting violation of the Act and require production of relevant documents. This authority is essential both to investigate violations and to assess the appropriate level of civil penalties once a violation is discovered.

This authority is essential to enforcement of the Bank Secrecy Act with respect to miscellaneous non-bank financial institutions such as casinos and foreign currency brokers, which number in excess of 3,000. The responsibility for compliance review of these institutions has been delegated to the Internal Revenue Service. However, currently, the IRS summons authority is restricted to Title 26 purposes. Therefore, in examining these institutions IRS must rely on voluntary cooperation.

Under this bill, a summons would be issued only by the Secretary or with his approval by a supervisory level official of an organization to which the Secretary has delegated Bank Secrecy Act enforcement authority, e.g., the Internal Revenue Service, the Comptroller of the Currency or the Customs Service. An agent or bank examiner in the field could not issue a summons on his or her own authority. H. 1367 by contrast provides that Treasury may not delegate summons authority. For Treasury, the ability to delegate summons authority is a practical necessity.

The bill also provides for a civil penalty for negligent violations of the Bank Secrecy Act. Currently, Treasury has authority to assess civil penalties for "willful" violations under 31 U.S.C. § 5321. "Willful" in a civil penalty context means with specific intent or with reckless disregard of the law. Nevertheless, mere negligent non-filing of currency reports deprives the government of potentially useful law enforcement information to the same extent as willful non-filings. The prospect of penalties for negligent violations should encourage financial institutions to give more attention to good compliance.

H.R. 2785 and 2786 also provide important revisions to the Right to Financial Privacy Act (RFPA). The revisions to the RFPA contained in the Administration's money laundering bill can be considered as an adjunct to that bill, with application separate from the subject of criminal money laundering legislation or enforcement of the Bank Secrecy Act.

The most important and least controversial of the revisions is the amendment to subsection 1103(c) of the RFPA, 12 U.S.C. § 3403(c). Currently, § 3403(c) provides that nothing in the Act shall preclude a financial institution from notifying a government authority that the institution has information "which may be relevant to a possible violation of any statute or regulation." The statute gives no guidance on what information can be given without running the risk of exposure to civil liability under the RFPA. The proposed amendment sets out explicitly that enough information can be given to enable Federal law enforcement authorities to proceed with legal process, e.g., summons, subpoena, or search warrant, in accordance with the RFPA. This information at a minimum must include the nature of the suspicious activity, the name of the customer, and other identifying information necessary to identify the customer or the account involved.

We believe you should find very little opposition in the financial community to this particular revision of the RFPA. The revision imposes no new legal duty on financial institutions, clarifies the right of financial institutions to act as good citizens without risk of civil liability, far outweighs any jeopardy to legitimate privacy interests, and would be of major assistance to Federal law enforcement.

For consistent application throughout the United States, this amendment must be accompanied by the proposed preemption provision so that a financial institution that complies with the RFPA will not run afoul of any more restrictive state privacy laws. The proposed clarification of the "good faith defense" to civil liability is also needed to protect financial institutions who cooperate with Federal law enforcement in good faith within the confines of the RFPA.

In addition to the Administration's money laundering bill, there is another legislative initiative on which I urge early and favorable action. That is the bill discussed in this Committee yesterday by Congressman Pickle.

This bill would prohibit structuring of currency transactions to avoid the $10,000 currency transaction reporting requirement. Structuring includes the well-known practice of "smurfing." Recent decisions in three Federal Circuits have made it clear that the current law is inadequate to sustain consistent prosecutions for structuring. The proposal would make a person who structures transactions to avoid the currency reporting requirements, or who causes a financial institution not to file a required report, subject to the criminal and civil sanctions of the Bank Secrecy Act.

The bill also provides seizure and forfeiture authority for currency related to a domestic (CTR) reporting violation or interest in property traceable to the currency. The forfeiture would not affect bona fide purchasers who took the currency or property without notice of a reporting violation. Currently, there is forfeiture authority only for monetary instruments underlying violations of the reporting requirements for internationally transported monetary instruments. The forfeiture would not be applicable to domestic financial institutions examined by a federal bank supervisory agency or a financial institution regulated by the Securities and Exchange Commission.

With respect to the other bills before the Committee, Treasury opposes two provisions in H.R. 1474. Section 3 of H.R. 1474 would provide that every Bank Secrecy Act reporting exemption be approved by the Secretary. Under the current regulations (31 C.F.R. § 103.22(b)), a bank may exempt from reporting certain cash deposits and withdrawals of accounts of retail businesses in amounts commensurate with the lawful, customary conduct of such a business. The bank has a continuing duty to monitor the qualifications for such exemptions, and it would be unwise, in our view, to shift the burden of monitoring the eligibility of bank customers for exemptions away from the bank. The bank is in the best position to know its customers and changes in their status. The provision is accordingly inefficient, overly burdensome and unnecessary.

Section 4 of H.R. 1474 would require that every person, including every financial institution, report all outgoing international wire transfers. As discussed above, with respect to Treasury's new international transaction reporting regulations, Treasury already has authority under 31 U.S.C. § 5314 to require reporting of international wire transfers. However, wholesale reporting of international wire transfers would not be in keeping with the restriction of § 5314 that Treasury consider the need to "avoid burdening unreasonably a person making a transaction with a foreign financial agency." This broad reporting requirement would create a virtual blizzard of reports, burdening financial institutions out of all proportion to the utility of the information generated and would bury the Treasury Department in an avalanche of reporting forms, all but a very few of which would be unrelated to money laundering.

I would now like to turn to H.R. 4280. This bill would make two major changes to the Bank Secrecy Act. First, it would amend 31 U.S.C. § 5313 to provide that the Treasury could only require reporting of domestic currency transactions in excess of $10,000. As you know, $10,000 is the reporting amount currently under Treasury regulations. We disagree strongly with this restriction on Treasury rulemaking flexibility and the ability to respond to changing law enforcement needs. There may be instances where the $10,000 reporting trigger is too high. For example, we have discussed various ways to address the smurfing problem by regulatory changes. One idea that has been circulated within Treasury is to require reports at the time of cash purchases of cashier's checks in excess of $3,000. This reporting requirement or similar use of the regulations to address such changing law enforcement problems would be precluded by H.R. 4280.

Another provision of H.R. 4280 would require a financial institution to keep special records relating to any cash transaction in excess of $3,000. Similar proposals have been under discussion within Treasury and within the Department of Justice as regulatory solutions to the various schemes being used to avoid the currency reporting requirements. We believe that a regulatory rather than legislative response is appropriate to address these situations, so that we can maintain the flexibility to respond to changing law enforcement needs. Moreover, in considering any proposal that imposes a new requirement on financial institutions, we must assess the cost and administrative burden to financial institutions in relation to the law enforcement interests served.

Another bill introduced by Congressman Wortly provides that Treasury review all exemptions not less than once a year and "in any case in which there is a change in management or control of a financial institution." As we have discussed above with respect to H.R. 1474, the annual review of all exemptions is a practical impossibility. However, we would have no objection to the review of exemptions when there is a change in control. We generally support increased attention to Bank Secrecy Act compliance at the time of changes in control.

Finally, Mr. Chairman, I want to express my appreciation for the continuing interest and support that you and the other members of this committee have demonstrated for Treasury's administration of the Bank Secrecy Act.

This concludes my prepared remarks. Mr. Stankey and I would be pleased to answer any questions the Committee may have.

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STATEMENT OF THE HONORABLE JAMES A. BAKER, III
SECRETARY OF THE TREASURY
OF THE UNITED STATES OF AMERICA

BEFORE THE MEETING OF THE OECD COUNCIL AT MINISTERIAL LEVEL
APRIL 17, 1986
PARIS, FRANCE

Toward Stronger Growth in the Debtor Nations

The international debt situation remains a challenge, not only for individual debtor nations but for the international community as a whole. However, recent developments give us cause for increasing optimism that the problems of debtor nations are manageable, and that growth can be restored through cooperative efforts on the part of all of the key players.

One of the most important developments during the past year has been the emergence of broad agreement among both creditor and debtor nations that improved "growth" in the debtor nations is essential to any resolution of their debt problems. The "Program for Sustained Growth" which the United States proposed at the Seoul meetings last October seeks to promote such growth.

This debt initiative has received broad and strong support from major industrial country governments and their central banks; the IMF, World Bank, and IDB; U.S. commercial banks accounting for more than 95 percent of outstanding U.S. bank claims on these countries, and national banking groups in all other major creditor countries, including Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, Saudi Arabia, and the United Kingdom.

We have also been heartened by the unanimous support for this approach expressed by the Group of Ten Finance Ministers and Central Bank Governors last week, and its endorsement by both the Interim and Development Committees.

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Improving the Global Environment

Understandably, a number of debtor nations have emphasized the importance of improvements in the global economic environment to support their own efforts to adjust their economies and improve their growth prospects. It is, indeed, the fundamental task of the industrial nations to help ensure a solid foundation for the implementation of the debt initiative through efforts to provide a world economic environment characterized by low inflation, low interest rates, sustained and more balanced growth, and open markets.

As we discussed this morning, we are making considerable progress in improving global economic prospects. Stronger industrial country growth and lower inflation this year will add $5 billion to developing nations' non-oil exports and reduce their import costs by approximately $4 billion. The sharp reduction in both short and long-term interest rates since early last year should reduce developing nations' debt service payments by $11 billion. In addition, the recent dollar depreciation should help reduce debt/export and debt service ratios for the debtor nations. All of these factors should help improve the outlook for commodity prices.

The sharp decline in oil prices will also help most debtor nations through reduced oil import costs, stronger growth and further interest rate reductions in industrial countries, and increased trade opportunities. We estimate that it will reduce oil import costs by an additional $13 billion for oil importing developing nations. While the financing needs of the oil exporting debtor nations will increase, we believe these requirements can be managed within the framework of the strengthened debt strategy.

These developments will contribute significantly to promoting developing nations' growth and easing their debt servicing obligations. All of this being said, however, these measures should not be viewed as a "fourth leg" to the debt initiative, but rather as a solid foundation upon which cooperative efforts in the debt area must rest.

Credible Policy Reform

The adoption of sound, growth-oriented, market-based macroeconomic and structural policies by the debtor nations themselves is the key to the improvement of their growth prospects, to encouraging increased equity investment, and to stimulating the return of flight capital.

In the absence of such policy improvements, stronger financial support from the international community will be stymied, and growth will not materialize. Implementation of the debt initiative therefore will depend critically on progress toward implementing comprehensive economic policies in individual debtor nations.

I recognize that these policies will take time to accomplish fully, that they will differ among countries depending on their individual circumstances, and that they will take time to put in place. (It is heartening, however, that a number of debtor nations are moving to reduce inflation and fiscal deficits, to allow exchange rates to be market-determined, to rationalize and privatize public enterprises, to adopt positive interest rates, and to improve the investment climate as an incentive to the return of flight capital.)

International Financial Institutions

I am also encouraged by the active role which the international financial institutions are playing in supporting these efforts. The IMF should continue to play a central role in this process, continuing to focus on sound macroeconomic policies, particularly fiscal, monetary, and exchange rate policy. The IMF now has existing or pending arrangements with 11 of the major debtor nations.

It is also important for the Fund to work closely with the World Bank, which, together with other development banks, should assume an enhanced role in supporting growth-oriented policies in the debtor countries. The World Bank's mission is focused on longer-term development issues, and it will play a key role in the structural policy area. Indeed, we expect that much of the World Bank's new lending will be fast-disbursing sector and structural adjustment loans as opposed to the more traditional project loans.

The World Bank is already moving ahead to strengthen procedures and policies to implement this expanded role. It is currently assisting major debtors in the development of medium-term adjustment programs. It also plans to implement procedures which will streamline operations and provide for a more comprehensive review of lending priorities for individual countries. Finally, Bank staff are working with private creditors in considering ways to better mobilize additional support for debtors' adjustment programs.

The World Bank currently has ample capacity to increase annual lending commitments by some $2 - $2.5 billion above FY 1985 and to concentrate that lending more heavily on the large debtors with credible reform programs. The U.S. is 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. I firmly believe, however, that crossing that line now would be counterproductive to the initiative and to the debt strategy as a whole.

The World Bank currently has structural or sector loan negotiations underway with 13 of the heavily indebted, middle income debtors. New structural or sectoral adjustment loans have already been signed with some of these countries, including Ecuador and Argentina, both of which are also discussing follow-on standby programs with the IMF. Other countries are at different stages in implementing comprehensive, growth-oriented economic programs. Implementation of the debt initiative, therefore, will depend on the pace of negotiations between individual debtor nations and the international financial institutions.

It will also be essential for the commercial banks to implement their pledges of financial support for debtors' reform efforts. We expect the banks will be consulting closely with both the IMF and the World Bank, as well as with the debtors themselves. They must be ready to do their part once the debtors have embarked on growth-oriented programs which have the support of the Fund and the World Bank.

For the low income debtor countries, we are very pleased with the action of both the Fund and the Bank on the Trust Fund initiative. This initiative provides a major step forward in Fund/Bank cooperation and a positive context for the IDA VIII negotiations. We look forward to its implementation in order that a basis for growth can also be established in those countries as well, and my colleague, Deputy Secretary of State John Whitehead, will have more to say about this initiative in a moment.

Before concluding, I would like to mention three areas that I believe deserve special attention: (1) efforts to improve the investment environment in debtor nations, (2) the importance of trade liberalization, and (3) tied aid credits.

Foreign Investment

Foreign investment must be an important component of our growth strategy. It is non-debt creating financing, and therefore doesn't increase the debt service burden. It also can provide a vehicle for the return of flight capital and a significant stimulus to entrepreneurial dynamism, increased efficiency, transfer of technology and managerial know-how which can facilitate structural change and growth. A hospitable climate for both domestic and foreign banking institutions would improve the efficiency and resource mobilization capability of the local market. This will also improve opportunities for swapping debt for equity, which has already had some success in some of the Latin American countries.

For most developing nations, however, both domestic and foreign investment has fallen significantly in recent years. Foreign direct investment in developing countries has declined from 20 percent of total flows in 1975 to just 11 percent in 1984. A number of factors underlie these trends, including:

-- the increased availability of commercial bank financing during the 1970s;

-- domestic retrenchment and capital flight in response to the debt crisis during the early 1980s;

-- the imposition of new restrictions and performance conditions on foreign investment; and

-- perceptions of increased political risk on the part of foreign investors, and poor growth prospects for the economy as a whole.

Reversing this trend, like reversing capital flight, will depend on a number of factors:

-- First, the adoption by debtors of sound macroeconomic policies, including positive real interest rates, realistic exchange rates, market-related prices, and a concerted attack on inflation;

-- Second, liberalizing investment regimes, which will signal investors of a more stable, predictable, and transparent policy environment over the longer run; and

-- Third, enhanced assurance against political risk, including expropriation and uncertainty about foreign exchange convertibility.

Support for the creation of the MIGA can help to encourage the flow of investment both to and among developing countries, through encouraging needed policy reforms as well as through its political risk and dispute settlement activities. Participation by developing countries in the negotiation of global rules governing foreign investment in GATT as part of the new round of trade negotiations could also help to improve the investment climate.

Trade

Global trade liberalization and expansion through the new trade round can provide a further boost to growth in the debtor countries and deserves their active support and participation. It does not make sense for these nations, however, to delay trade policy reforms in their own economies which can contribute to stronger growth while awaiting the completion of global trade negotiations. The United States is therefore prepared to consider giving credit in the new round for trade liberalization measures adopted as part of debtor nations' domestic policy reforms, and subsequently bound in the GATT negotiations. We hope other industrial countries will show a similar willingness to give appropriate credit for these measures.

It will also be important, however, for the OECD nations to maintain open markets as growth improves to permit increased export earnings for the debtor nations, and to maintain cover on export credits for countries which adopt sound adjustment policies. Officially supported trade finance is crucial to maintaining essential imports in support of adjustment efforts. In this regard, I was very pleased with the affirmation by the Group of Ten Ministers and Governors last week of their willingness to cooperate regarding resumption of export credit cover to countries implementing appropriate adjustment policies. I hope that the OECD as a whole can similarly agree to move in this direction.

Tied Aid Credits

Last April all OECD Ministers agreed that prompt action should be taken to improve discipline and transparency over tied and partially untied aid credits. Continued use of such credits in order to promote exports distorts trade, misallocates aid, undermines the Export Credit Arrangement, and adds unnecessarily to tension in international trade relations. Despite the Ministerial mandate, the tied aid credit problem has not been resolved in the past year, nor is it dwindling in importance. Notified tied aid credits have increased from $4 billion in 1982 to over $8 billion in 1985.

We have an opportunity to resolve this problem at this Ministerial. The simplest and most direct solution is to raise the level of concessionality. Significantly increasing the aid component of tied and partially untied aid credits will limit their usefulness as trade promotion devices.

The report of the Chairman of the Export Credits Group sets the stage for resolution of this problem. The United States can support most of the elements of the Chairman's proposal. In particular, we can accept the Chairman's proposal for staged increases in the grant element for the middle income group of developing countries provided that the final minimum permissible grant element is high enough. We would consider a staged increase to 35 percent, however, as too low.

We also can accept the proposal by the Chairman and the European Community for a change in the method for calculating the grant element to reflect the actual cost of aid as part of a package with a significant increase in the grant element. We oppose a lower grant element for partially untied aid credits.

I realize that these proposals will have a significant impact on programs in a number of OECD governments, including the United States. This impact is a necessary outgrowth of achieving fair and equitable discipline over current practices of tied and partially untied aid credits. Nonetheless, in order to ease the immediate impact of these changes, we are ready to agree with the Chairman's proposal to phase in both the increase in the grant element and the proposed revision in the method of calculating the grant element beginning on July 1, 1986.

Japan has been making strong statements about the need to reduce the Japanese trade surplus in order to reduce international trade frictions. Consistent with this objective, I would urge Japan to join the emerging consensus and go along with the changes proposed by the European Community to resolve the tied aid credit issue. It is no answer, in our view, to say that the change in the method of calculating the grant element penalizes low interest rate countries. Such countries have had in effect a free ride for a long time and all this does is cancel out a longstanding advantage.

The U.S. Congress is closely following our efforts to increase discipline over tied and partially untied aid credits. Earlier this week, the Senate and House of Representatives adopted a resolution deploring the predatory use of tied and partially untied aid credits and indicated that Congress would be willing to take additional steps if successful negotiations are not concluded.

Therefore, like Nigel Lawson, I urge Ministers to support efforts to resolve this problem now. It is not a matter that we should have to confront at the Summit or in other fora.

Conclusion

In summary, let me say that we are encouraged by the positive developments which have occurred in recent months. It is important, however, to maintain the momentum that already exists, because much still remains to be done. We believe that with a continued cooperative approach by all, the growth aspirations of debtor countries can be realized -- for their benefit and that of the global community as a whole.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. April 16, 1986

TREASURY TO AUCTION $9,750 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $9,750 million of 2-year notes to refund $8,079 million of 2-year notes maturing April 30, 1986, and to raise about $1,675 million new cash. The $8,079 million of maturing 2-year notes are those held by the public, including $452 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $9,750 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 $1,129 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

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED APRIL 30, 1986

April 16, 1986

Amount Offered:	
To the public	$9,750 million
Description of Security:	
Term and type of security	2-year notes
Series and CUSIP designation	Y-1988 (CUSIP No. 912827 TN 2)
Maturity Date	April 30, 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	October 31 and April 30
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, April 23, 1986, prior to 1:00 p.m., EST
Settlement (final payment due from institutions)	
a) cash or Federal funds	Wednesday, April 30, 1986
b) readily-collectible check ..	Monday, April 28, 1986

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

For Release Upon Delivery
Expected at 9:30 a.m., EST
April 21, 1986

STATEMENT OF
J. ROGER MENTZ
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to discuss the Treasury Department's views regarding the proposals in Chairman Packwood's tax reform markup document (the "Chairman's Plan") relating to Federal excise taxes and tariffs. The proposals would make Federal excise taxes and tariffs nondeductible for Federal income tax purposes, increase the rate of Federal excise tax on certain wines to the rate currently applied to beer, and adjust the rates of Federal excise tax on alcohol and tobacco products and certain fuels to reflect future price increases.

The achievement of fundamental tax reform is a central goal of this Administration. In the President's view, the key elements of a revenue-neutral tax reform bill are a full $2,000 personal exemption for both itemizers and nonitemizers, at least for individuals in the lower- and middle-income tax brackets; a rate structure with a maximum rate no higher than 35 percent; tax brackets that reduce taxes for middle-income working Americans; basic tax incentives for American industries, including those which depend upon heavy capital investment in equipment and machinery; and a minimum tax which allows no individual or business to escape paying a fair share of the overall tax burden. The President believes that these changes will promote future economic growth, improve the fairness of the tax system, and simplify the system for millions of individual taxpayers.

As the tax reform process has moved forward, the Administration, the House Ways and Means Committee, and now the Senate Finance Committee have come to recognize the difficulty of raising enough revenue from the income tax system to accomplish fundamental changes. The Administration's tax reform proposals did not include provisions comparable to those in the Chairman's Plan relating to excise taxes and tariffs. Instead, we proposed general base broadening to maintain the revenue neutrality of our tax reform plan. We encourage renewed consideration of those tax reform proposals made by the Administration and not incorporated in the Chairman's Plan that would raise additional revenues. In addition, we support efforts by the Committee to develop alternative revenue raising proposals that are consistent with the President's tax reform goals. If, however, the base-broadening and other revenue raising proposals that are accepted by the Committee do not raise sufficient revenues, we could support raising revenue through excise tax changes in the context of revenue-neutral tax reform that meets the President's goals. It is in that spirit that we consider the excise tax and tariff proposals that are included in the Chairman's Plan.

My testimony is divided into three major sections, corresponding to the three proposals in the Chairman's Plan relating to excise taxes and tariffs: the denial of an income tax deduction for Federal excise taxes and tariffs; an increase in the excise tax rate on wine; and adjustments in certain excise tax rates to reflect price changes. The proposal to deny the deductibility of Federal excise taxes and tariffs raises the most revenue and requires more complex analysis than the other two proposals, so I will turn to it first.

Proposal to Deny Deductibility of Federal Excise Taxes and Tariffs

Background

Under current law, Federal excise taxes and tariffs are imposed on a wide range of goods, services, and activities. For fiscal year 1986, total Federal excise tax revenues are estimated to be over $34 billion. Of this amount, approximately $17 billion are general tax revenues and the remaining $17 billion are earmarked for designated spending purposes. This earmarking occurs by way of an automatic appropriation to a segregated trust fund, such as the Highway Trust Fund, of an amount equivalent to the receipts from certain excise taxes. A schedule listing the significant Federal excise taxes and the amount of projected revenues for fiscal year 1986 is attached as Appendix A. During calendar year 1985, total Federal tariff collections were approximately $11.5 billion. A schedule listing the major categories of Federal tariffs is attached as Appendix B. Although it is not possible in the time that is available to me to discuss each of the Federal excise taxes and tariffs, a brief description of several of the excise taxes and tariffs that generate very substantial revenues may be helpful.

Distilled Spirits. The Federal excise tax on distilled spirits is imposed on the producer or importer of distilled spirits at the rate of $12.50 per "proof gallon." This rate was increased in October 1985 from $10.50 per proof gallon. A proof gallon is the volume of distilled spirits containing the same amount of alcohol as one gallon of 100 proof (50 percent alcohol) distilled spirits. For example, one gallon of 80 proof distilled spirits is equal to 0.8 proof gallons, and is subject to a Federal excise tax of $10.00. In general, the excise tax on distilled spirits becomes payable when the spirits are removed from the bonded premises of the producer or importer. The excise tax typically is treated as a cost of goods sold in determining the taxable income of the taxpayer. The distilled spirits excise tax is expected to generate receipts of $4.0 billion in fiscal year 1986. Revenues from the tax are included in the general fund.

Wine. The Federal excise tax on wine is imposed on the producer or importer of the wine. The rate of tax varies depending on the alcohol content and carbonation of the wine, as follows: $0.17 per gallon (a standard measure gallon as opposed to a proof gallon) on still wines containing not more than 14 percent alcohol; $0.67 per gallon on still wines containing more than 14 percent alcohol and not more than 21 percent alcohol; $2.25 per gallon on still wines containing more than 21 percent and not more than 24 percent alcohol; $2.40 per gallon on artificially carbonated wines; and $3.40 per gallon on champagne and other sparkling wines. Wines containing more than 24 percent alcohol are taxed as distilled spirits. In general, the tax becomes payable when the wine is removed from the bonded premises of the producer or importer. The excise tax typically reduces taxable income as a cost of goods sold. Wine excise tax receipts are expected to be $276 million in fiscal year 1986. Revenues from the tax are included in the general fund.

Beer. The Federal excise tax on beer is imposed on the producer or importer of the beer. The rate of tax is $0.29 per gallon ($0.226 per gallon in the case of certain small domestic producers), and does not vary based on alcohol content. In general, the excise tax on beer becomes payable when the beer is removed from the bonded premises of the producer or importer. The excise tax typically reduces taxable income as a cost of goods sold. Beer excise tax receipts are expected to be $1.6 billion in fiscal year 1986. Revenues from the tax are included in the general fund.

Tobacco Products. The Federal excise taxes on cigarettes and certain other tobacco products are imposed on the manufacturer or importer of the products. The rate of tax on most cigarettes is $8.00 per thousand ($0.16 per pack of 20). In 1983, this rate was temporarily increased to the present level from $4.00 per thousand ($0.08 per pack of 20); the rate has been fixed at the present level by the Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272). In general, the excise taxes on tobacco products become payable when the products are removed from the bonded premises of the manufacturer or importer. The taxes typically reduce taxable income as a cost of goods sold. Excise tax receipts from tobacco products are expected to be $4.6 billion in fiscal year 1986. Revenues from the taxes are included in the general fund.

Gasoline. The Federal excise tax on the sale or use of gasoline is imposed on the producer or importer of gasoline at the rate of $0.09 per gallon. The tax becomes payable at the time of the sale or use by the producer or importer. The tax typically reduces taxable income as a cost of goods sold. After accounting for refunds and other adjustments, the gasoline tax is expected in fiscal year 1986 to yield $8.6 billion to the Highway Trust Fund and an additional $71 million to the Aquatic Resources Trust Fund. Revenues included in the Highway Trust Fund are used for Federal-aid highway and other ground transportation programs.

<u>Diesel Fuel</u>. The Federal excise tax on diesel fuel is imposed on the seller (or, in the absence of a sale, on the user) of diesel fuel used in a diesel-powered highway vehicle. The rate of tax is $0.15 per gallon. This rate was increased in August 1984 from $0.09 per gallon. The tax becomes payable at the time a sale is made to an owner or operator of a diesel-powered highway vehicle (or, in the absence of a sale, at the time the fuel is used in a diesel-powered highway vehicle). The tax typically reduces taxable income as a cost of goods sold. Receipts from the diesel fuel excise tax are expected to be $2.6 billion in fiscal year 1986. Revenues from the tax are included in the Highway Trust Fund.

<u>Heavy Trucks and Trailers</u>. The Federal excise tax on heavy trucks and trailers is imposed on the person who makes a retail sale of (or, in the absence of a retail sale, who uses) a truck or trailer chassis or body, or of a tractor of the kind chiefly used for highway transportation in combination with a trailer or semitrailer. The rate of tax is 12 percent of the sales price of the truck or trailer. Exclusions are provided for truck chassis or bodies suitable for use with a vehicle having a gross vehicle weight of 33,000 pounds or less and for trailer and semitrailer chassis and bodies suitable for use with a vehicle having a gross vehicle weight of 26,000 pounds or less. The tax typically reduces taxable income as a cost of goods sold. Receipts from the heavy truck and trailer tax are expected to be $1.2 billion in fiscal year 1986. Revenues from the tax are included in the Highway Trust Fund.

<u>Highway Truck Use</u>. The Federal highway truck use tax is an annual tax imposed on the user of any truck that (together with the trailers customarily used in connection with trucks of the same type) has a taxable gross weight of at least 55,000 pounds. The rate of tax ranges from $100 per year, in the case of trucks having a taxable gross weight of 55,000 pounds, to $550 per year, in the case of trucks having a taxable gross weight of over 75,000 pounds. These tax rates were reduced, and the weight threshold increased, in July 1984, in conjunction with the increase in diesel fuel tax rate described above. The highway truck use tax typically is deducted as an ordinary and necessary business expense. Receipts from the tax are expected to be $0.4 billion in fiscal year 1986. Revenues from the tax are included in the Highway Trust Fund.

<u>Telephone Communications</u>. The Federal telephone communications tax is imposed on any person paying for local telephone, toll telephone, or teletypewriter exchange service. The tax is collected by the service provider. The rate of tax is equal to three percent of the amount paid for

such communications services. In the case of telephone services purchased by businesses, the tax typically is deducted as an ordinary and necessary business expense. In the case of telephone services purchased by nonbusiness customers, the tax typically is treated as a personal expense for which no deduction is allowed. Receipts from the telephone communications tax are expected to be $2.6 billion in fiscal year 1986. Revenues from the tax are included in the general fund.

Air Transportation. The Federal air transportation tax is imposed on any person paying for transportation by air that begins and ends in the United States or in a zone encompassing parts of Canada and Mexico that are within 225 miles of the continental United States. The tax is collected by the service provider. The rate of tax is equal to eight percent of the amount paid for such transportation. In the case of air transportation purchased by businesses, the tax typically is deducted as an ordinary and necessary business expense. In the case of air transportation purchased by nonbusiness customers, the tax typically is treated as a personal expense for which no deduction is allowed. Receipts from the air transportation tax are expected to be $2.6 billion in fiscal year 1986. Revenues from the tax are included in the Airport and Airway Trust Fund. These funds are used to cover the cost of Federal Aviation Authority operations, provide for air traffic control modernization, and provide grants for airports.

Windfall Profit Tax. The crude oil windfall profit tax is imposed on the producer of domestically-produced crude oil. Foreign-produced crude oil imported into the United States is not subject to the tax. The producer is the person holding the "economic interest" with respect to the oil. This economic interest is normally shared by various parties (including owners of royalty interests) who participate in the production of the oil. The tax applies to the "windfall profit" element in each barrel, i.e., the excess (if any) of the removal price of the oil over its inflation-adjusted "base price," less an adjustment for any state severance tax. The base price of the oil and the rate of windfall profit tax vary depending on the classification ("tier") of the oil and the identity of the producer. The current average base prices of Tier 1, Tier 2, and Tier 3 oil are $18.43, $21.93, and $28.75, respectively. The rates of tax on the windfall profit element of the oil range from 70 percent on Tier 1 oil to 22.5 percent on Tier 3 oil. Independent producers are taxed at lower rates than integrated oil producers on Tier 1 and Tier 2 oil, and are not taxed at all on stripper well oil. The windfall profit tax typically is deducted by the producer as an itemized deduction under section 164(a)(5). The Administration's 1987 Budget forecast of receipts in fiscal year 1986 from the windfall profit tax was $4.2 billion. At current price levels for crude oil, however, the windfall profit tax is not expected to generate a significant amount of revenue. Revenues from the windfall profit tax are included in the general fund.

Tariffs. Federal tariffs are imposed on the importer of the product and become payable when the product enters the customs territory of the United States. Tariffs typically reduce the importer's taxable income as a cost of goods sold. Tariff revenues are included in the general fund.

During 1984, total Federal tariff collections were equal to 3.7 percent of the value of all goods imported into the United States. No tariff is imposed on certain categories of imported goods, so that the average tariff rate on imported goods actually subject to tariff was 5.5 percent of value. Tariff rates vary widely, moreover, among general product categories and among the particular products within each general product category. For example, on a trade-weighted basis, textile fibers and products (including apparel) imported into the United States are subject to an average tariff rate of 19.8 percent of the value of the product. Within this category, men's or boy's wool knit coats, suits, trousers, slacks, and shorts generally are subject to a tariff rate of 31.4 percent, while men's and boy's cotton knit shirts and sweaters generally are subject to a tariff rate of 21 percent.

Description of the Proposal

The Chairman's Plan would disallow any deduction or other reduction of income for Federal income tax purposes for the payment of any Federal excise tax or tariff. Thus, the amount of any Federal excise tax or tariff could not be deducted as an ordinary and necessary business expense or an expense incurred for the production of income, offset against income from the sale of property as a cost of goods sold, or added to the adjusted basis of depreciable property. The legal incidence of several Federal excise taxes would be clarified or changed to reduce the number of situations in which the ultimate consumer of the taxable good or service would be the person liable for the tax. For example, the legal incidence of the telephone communications and air transportation taxes would be shifted to the person providing the services. Presumably, no change would be made with respect to those excise taxes (such as the excise taxes on certain "prohibited transactions" of tax-exempt organizations and on certain "golden parachute" payments) that are nondeductible under current law.

The proposal also includes an "anti-avoidance" rule to ensure that the deduction disallowance has the effect of increasing the income tax liability of the payor of the excise tax or tariff by the amount of the tax or tariff multiplied by the maximum corporate income tax rate. For example, if the legal incidence of an excise tax falls on a corporation with net operating losses, an individual taxed at a marginal rate of less than 35 percent, or a foreign person not otherwise subject to tax in the United States, the corporation, individual, or foreign person would be treated as having a separate "basket" of income equal to the amount of the excise tax or tariff. The income in this basket could not be reduced by any deductions, and would be taxed at the maximum corporate income tax rate of 35 percent. The resulting tax could not be offset by credits.

Our preliminary estimate is that the proposal would raise $66.5 billion over fiscal years 1986-1991. The major components of this revenue increase are as follows:

	1986-1991 Amount ($ Billions)
Excise Taxes:	
Alcohol	9.0
Tobacco	7.5
Gasoline	15.5
Diesel Fuel	5.0
All Other Excises	13.6
Total Excises	50.6
Tariffs	15.9
Total	66.5

All of the additional income tax revenues would be included in general revenues.

Discussion

Although the denial of a deduction for Federal excise taxes and tariffs would, in form, affect only Federal income tax liabilities, we believe the proposal would be similar in effect to, and thus is appropriately analyzed as, a direct increase in Federal excise taxes and tariffs. As with a direct increase in these levies, the additional tax burden resulting from the proposal would vary directly with the number of units sold subject to the tax. For example, under the proposal, as under the existing cigarette excise tax, domestic sales of cigarettes by a cigarette manufacturer would generate tax liabilities proportional to the number of cigarettes sold. In contrast, liabilities under the income tax are not based on the number of units sold, but rather on the return to equity capital used in the production of the particular good.

Although we believe the proposal is similar in effect to a direct increase in excise taxes and tariffs, it should be noted that the amount of this effective increase will vary with the marginal tax rate of the person subject to the levy. As with a direct increase in excise taxes and tariffs, sellers of the taxed goods will attempt to avoid the economic burden of the proposal by passing that burden on to purchasers in the form of higher prices. The price increase required to shift the burden fully to purchasers will depend, however, on the marginal income tax rate that applies to the seller. For sellers in the 35 percent income tax bracket, a price increase equal to 54 percent of excise tax and tariff liabilities would be required to maintain the prior level of after-tax profits.*

* If excise taxes are deductible as under current law, a 35 percent bracket taxpayer subject to a one dollar excise tax must increase his prices by one dollar in order to cover that liability and leave his income tax liability (and hence his after-tax income) unchanged. If, as under the proposal, the one dollar excise tax is no longer deductible, the taxpayer must increase prices by an additional amount to cover the income tax attributable to the lost one dollar deduction, *plus* the income tax attributable to the price increase. In other words, a price increase will create additional income tax liability that will, in turn, require an additional price increase. Thus, a 35 percent bracket taxpayer will not fully recover the extra income tax liabilities from the lost deduction unless his prices are increased by $.54. The $.35 is equal to the $.35 income tax on the lost deduction (35% x $1.00 = $.35), plus the $.19 income tax on the price increase (35% x $.54 = $.19). A larger price increase would be required in the case of an *ad valorem* tax, since any price increase would increase the taxpayer's excise tax liability as well as his income tax liability.

For taxpayers with less than a 35 percent marginal tax rate, the effective increase in excise tax or tariff rates will be somewhat smaller. For example, taxpayers with a zero marginal tax rate would be required to pay an income tax of 35 percent of their Federal excise and tariff payments under the proposal's "anti-avoidance" rule. Such taxpayers could maintain their after-tax income by increasing prices by 35 cents for each dollar of current excise tax or tariff liability. Thus, for these taxpayers the proposal is equivalent to only a 35 percent increase in excise taxes and tariffs.* Taxpayers subject to income tax at a rate between zero and 35 percent are in an intermediate position; to maintain after-tax income they must increase their prices by between 35 percent and 54 percent of their excise taxes and tariffs, depending on their marginal income tax rate. Also in an intermediate position are taxpayers with net operating losses. Although their current marginal tax rate is zero, net operating losses used to offset current price increases would no longer be available to offset possible taxable income in future years.

Economic Effects

The ability of sellers to shift the tax burden under the proposal to purchasers depends on the responsiveness of purchasers and sellers of the taxed good to changes in price. If purchasers are relatively unresponsive to such changes (i.e., they will not significantly reduce their purchases of the good if the price increases), then purchasers will tend to bear more of the burden of an excise tax on the good than will sellers of the good. The degree of responsiveness of purchasers to changes in price depends largely on the availability of substitute goods. On the

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* As in the preceding example, under current law, taxpayers with no marginal income tax liability need to increase prices by only one dollar in order to cover a one dollar excise tax liability and leave their after-tax income unchanged. Under the proposal, these taxpayers must increase prices by an additional $.35 to cover the $.35 "anti-avoidance" tax and thus leave their after-tax income unchanged. Because the $.35 increase in price would not create additional income tax liability, no additional price increase would be required.

other hand, if sellers of the good are relatively unresponsive to changes in price (i.e., they will not significantly reduce their supply of the good if the price they receive for the good decreases), then land, labor, and capital used in the business of providing the good will tend to bear more of the burden of the tax. The degree of responsiveness of sellers to changes in price depends largely on the availability of alternative uses for the land, labor, and capital used in producing the good.

In the very long run, the supply of most goods can be expected to be highly responsive to changes in price, since with sufficient time the quantity supplied of most goods can be increased (or decreased) at a relatively constant unit cost. If sellers are unable to pass on to purchasers the full amount of an of excise tax or other cost increase, the rates of return to land, labor, and capital used in the industry will fall. The reduced rates of return will cause land, labor, and capital that would otherwise have been employed in providing the good to be employed in other sectors of the economy that offer a higher rate of return. In theory, the rates of return to land, labor, and capital in different sectors of the economy would move back toward equilibrium over time, and the burden of the excise tax or other cost increase would be fully reflected in prices. Depending on the responsiveness of the purchasers to price increases, the long-run shift of the excise tax to purchasers may result in a relatively small or a relatively large reduction in the market for the good.

The magnitude of the reduction in the market for the good will largely determine how quickly the adjustment to the new equilibrium takes, how disruptive it may be, and the extent of its effect on markets for other goods. Any reduction in the market for the good as a result of an increase in excise taxes would in turn reduce the amount of land, labor, and capital required to produce the good. Over time these factors of production would find employment in other industries, but during the transition period there could be windfall losses in the form of reduced earnings, or even unemployment. At the same time, land, labor, and capital employed in producing goods not subject to excise taxes, goods which have become relatively cheaper, may receive windfall gains as purchases of those goods increase.

It should be noted that even if the full tax burden of the proposal is shifted to purchasers, the relative change in the price of the affected goods would be quite small in relation to the effective increase in excise taxes or tariffs. The table below illustrates this point.

Product	Approximate Percentage Increase in Retail Price Due to Nondeductibility Assuming: 50 Percent Tax Passthrough	100 Percent Tax Passthrough
Pack of 20 cigarettes a/	4.0%	8%
Six-pack of beer b/	1.5	3
Gallon of gasoline c/	2.5	5

a/ Retail price of $1.05, from industry sources, used in calculations. Current Federal excise rate is $.16.

b/ Retail price of $3.21, from industry sources, used in calculations. Current Federal excise rate is approximately $.16.

c/ Retail price of $.91 as reported in the Oil and Gas Journal for the week of April 9, used in calculations. Current Federal excise rate is $.09.

Special Circumstances

Although valid as a general model, the above analysis as to the economic effects of the proposal must be modified in certain circumstances. For some goods, long-run supply will not be highly responsive to price changes because the factors (land, labor, and capital) used to produce the good are quite specialized to its production. These factors are in limited supply and exhaustible, such as oil reserves, or have few (if any) alternative uses, and therefore cannot be shifted to the production of alternative goods. For such goods, even in the long run, the burden of an excise tax is borne at least partially by the specialized factors, rather than entirely by purchasers.

Second, the burden of an excise tax will not be passed on to purchasers where the tax does not apply to all producers of the good, and the market price is determined by reference to goods that are not subject to the tax. In particular, the windfall profit tax cannot be passed on to purchasers because the price of oil is determined in the world market, which does not reflect an excise tax imposed strictly on domestic production. All of the additional windfall profit tax burden under the proposal would therefore be borne by owners of domestic oil.

Third, although an increase in excise taxes or tariffs generally will cause temporary market dislocations, if a market is already disrupted because prices are below their long-run equilibrium level, an increase in excise taxes or tariffs may be stabilizing. This may be true currently for petroleum markets, where the recent large decline in oil prices arguably has reduced the price for oil and possibly other energy products below their long-run equilibrium level.

Finally, it is possible that sellers of a good or service subject to an excise tax or tariff will be differentially affected by the proposal. As noted above, the effect of the proposal on an individual seller will depend on the seller's marginal income tax rate. If the market price of a good is determined by sellers in the 35 percent income tax bracket, full passthrough to customers of the additional tax burden from the proposal would produce a price increase of 54 percent of excise tax or tariff liabilities. Sellers of the good with marginal income tax rates of less than 35 percent also will raise their prices by 54 percent of the excise tax or tariff, but could have recovered the excise tax or tariff with a smaller increase. Thus, in these circumstances, low-bracket taxpayers would receive a windfall (notwithstanding the anti-avoidance rule). Similar differential effects on sellers would occur in any market where at least a portion of the tax burden is passed on to purchasers, and different sellers are in different marginal income tax brackets.

Effect on International Trade

The proposal to deny an income tax deduction to the payor of an excise tax would have a mixed effect on the international trade position of the United States. Excise taxes on consumer goods such as alcohol and tobacco products are applied equally to imported as well as domestically-produced goods. Therefore, domestically-produced goods of this type would generally not be advantaged or disadvantaged by the proposal as compared to foreign-produced goods. Excise taxes that apply to goods and services purchased in significant quantities by businesses, such as trucks, fuels, and telephone services, would increase costs, and eventually prices, of a wide range of domestically-produced goods. Since comparable levies could not be imposed on imports that use such goods and services, some domestic producers would be disadvantaged by the proposal. In contrast, domestic producers that compete with imports would be advantaged by the effective increase in tariffs under the proposal. The effects on imports and exports would to some extent offset, and, on balance, we would expect a relatively small decline in the level of exports and imports.

Tax Policy Considerations

Justification for Selective Excise Taxes. As I have already stated, we believe that the proposal to deny a deduction for the payment of Federal excise taxes is properly analyzed as similar in effect to a direct increase in excise taxes. In evaluating the proposal, it is thus necessary to consider the circumstances in which the imposition of an excise tax or an increase in existing rates may be justified.

1. External Social Costs. One of the traditional justifications for imposing an excise tax is to ensure that the market price of a good reflects any external social costs associated with its production or consumption. The free market will efficiently allocate economic resources to the extent that, "at the margin," all of the economic costs to society of the good are reflected in the price charged by the producer and all of the economic benefits to society of the good are reflected in the price paid by the consumer. In most cases, essentially all of the costs to society of the good are borne by the producer, and hence will be reflected in the price charged by the producer. Similarly, essentially all of the benefits to society are received by the consumer, and hence will be reflected in the price paid by the consumer. In some cases, however, the social costs of producing or consuming a particular good exceed the cost to the producer or consumer. These external, uncompensated costs are borne by other members of society who do not directly benefit from the production or consumption of the good. When external costs are present, the imposition of an excise tax can make the allocation of economic resources more efficient by raising the price of the damaging activity and thereby internalizing the external cost.

For example, it is widely accepted that the public health and other social costs resulting from the consumption of alcoholic beverages and tobacco products would not be reflected in the price for these products that would be set by market factors alone. To illustrate, the external costs attributable to alcohol abuse include such direct costs as property damage and personal injuries incurred by innocent victims of alcohol-related auto accidents, as well as such indirect costs as the burden of extra health care costs shifted from an alcoholic to society at large by insurance or public health care programs. Although excise taxes are currently imposed on alcohol and tobacco products, many believe that the current tax levels do not adequately reflect the external costs of these products. Some evidence that this view is widely held is the fact that current law also places restrictions on the advertisement of these products. It is notable as well that a group of prominent economists recently has called for substantial increases in the Federal excise taxes on alcohol.*

It also may be true that the market prices of gasoline and other petroleum products, particularly at the current depressed levels, do not fully reflect the social costs of producing or consuming these products. For example, among the external social costs associated with gasoline consumption are air pollution and the prospect that future economic growth may be endangered by reliance on uncertain foreign supplies of oil. In addition, increased excise taxes on petroleum products also may be appropriate to encourage energy conservation and thus reflect the value of nonrenewable resources to future generations.

2. Surrogate User Fees. The imposition of an excise tax also may be justified as a surrogate user fee where the Federal government provides services that directly benefit users of certain goods or services. Examples of such surrogate user fees are the Federal excise taxes on gasoline and diesel fuels, most of the revenues from which are used for Federal-aid highway programs. Excise taxation of certain goods, such as motor fuels, may be justified both as a surrogate user fee and as a way to internalize external costs.

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* A group of 67 economists, including Nobel laureates Franco Modigliani, Paul Samuelson, and James Tobin, has signed a petition supporting efforts to increase Federal excise taxes on alcoholic beverages and eliminate or modify the differential tax treatment between beer, wine, and distilled spirits. See Tax Notes, March 17, 1986, p. 1178.

3. <u>Demand Unresponsive to Price Changes</u>. A final justification for imposing excise taxes is their ability, in certain circumstances, to raise revenue with minimal distortion of consumer choices. If demand by consumers for a particular good is quite unresponsive to price changes, an excise tax on that good would cause very little change in the amount of the good consumers would purchase. Hence, distortion of consumer choices would be minimized. Since a basic goal of tax policy is to raise revenue without distorting economic behavior, an excise tax may in some circumstances be a legitimate alternative to more broadly based tax measures.

Use of Revenues

Excise taxes serve to reflect external social costs or user benefits in two ways. First, by increasing the price of the taxed good, they reduce demand for the good and thereby the level of associated external costs, or the need to provide associated user benefits. Second, the excise taxes provide revenues to help pay for associated external costs or user benefits. These revenues may be used directly in related government programs, for example, to finance highway construction. These revenues also may be used to reduce other Federal taxes, and thus provide indirect compensation for the external costs borne by private persons. Excise taxes on goods with price-unresponsive demand also could provide revenue to replace revenues from other sources that distort economic behavior to a greater extent. Thus, under the proper circumstances, we believe it would be reasonable to use certain excise tax revenues as a means of reducing income tax burdens, as the Chairman's Plan contemplates.

Distributional Impact

One of the President's principal tax reform objectives is that families below the poverty line not be required to pay Federal income taxes. The President's tax reform proposals sought as well to reduce the tax burden on middle-income working Americans. These objectives relate to the basic fairness of the tax system, and require that we carefully evaluate the distributional impact of the proposal to deny a deduction for Federal excise taxes and tariffs.

In general, the distributional effect of the proposal will depend on the extent to which the incidence of the excise taxes and tariffs are passed on in price increases, as well as on the consumption by different income classes of the goods and services subject to the levies. Conventionally, analysis of the distributional effect of excise taxes is based on the assumption that these levies are fully passed on to customers, and on calculations using annual income and consumption data. These data show consumption to represent a higher percentage of income for lower-income than for higher-income families. Accordingly, these conventional calculations would show the distributional effect of the proposal to be regressive.

For several reasons, however, income and consumption are more closely related over time than they are in any given year. For example, young families tend to spend a higher proportion of their incomes than middle-aged families (who tend to have higher incomes), while at retirement, income normally falls by a greater amount than consumption. Further, in any given year, some families will maintain their "normal" spending levels in spite of low income due to illness, unemployment or windfall losses, while other families will maintain "normal" spending patterns in spite of windfall gains. Thus, relying on annual consumption data to distribute the excise tax burden makes these taxes appear to be more regressive than they would if lifetime consumption and income data were relied upon.*

In addition, the nature of some excise taxes suggests that their distributional consequences might be properly judged from a different perspective. As discussed earlier, some excise taxes are justified because market prices are too low, either because they do not reflect external costs associated with production or consumption of the good, or because they do not reflect government benefits provided to users of the good. The burden of these taxes is therefore comparable to the prices paid for privately consumed goods and services. Individuals who do not consume the taxed goods, and therefore do not impose external costs on others or receive user benefits, do not have a tax burden. In contrast, the burden of the income tax is not directly related to any external cost or specific government expenditure benefit.

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* See James Davies, France St-Hilaire, and John Whalley, "Some Calculations of Lifetime Tax Incidence," _The American Economic Review_, September 1984, p. 633.

Finally, as a matter of tax policy, we should neither accept nor reject a single provision of a comprehensive tax reform package on the basis of its distributional impact considered in isolation. As the Administration has consistently emphasized, attention should be focused on the distributional effects of the package as a whole. If consideration of the package as a whole suggests its distributional effects are inappropriate, there are a number of ways in which the package could be tailored to alter these effects.

Tax Treaty, GATT, and Related Issues

Tax Treaties. Application of the anti-avoidance rules of the proposal to certain foreign persons who are not currently subject to U.S. income tax could violate the business profits article of numerous income tax treaties that the United States has entered into with foreign countries, including treaties with Canada, France, Germany, Japan, and the United Kingdom. Generally, the business profits article of an income tax treaty prohibits one treaty country from taxing the business profits derived by a resident of the other treaty country unless such profits are attributable to a permanent establishment in the first treaty country.

GATT and Related Issues. Denial of an income tax deduction to the payor of a tariff would raise issues under the General Agreement on Tariffs and Trade (GATT). Article II of the GATT prohibits the imposition of tariffs in amounts higher than those agreed to in international negotiations. In addition, it could be argued that the proposal nullifies or impairs the benefits of tariff concessions granted to other countries.

If the proposal were found to violate the GATT or to nullify or impair benefits under the GATT, the United States would be expected to offer compensation to those countries which were adversely affected. Compensation would normally be in the form of reduced duties. If the United States did not offer adequate compensation, other countries would be entitled to retaliate against U.S. exports. Reduced duties on imports into the United States or increased foreign duties on U.S. exports would result in reduced sales and income for U.S. producers.

Even if the denial of a deduction for the payment of tariffs were found not to violate the GATT, the proposal might have a detrimental effect on foreign trade. Other countries, most of which allow tariffs to be deducted for purposes of measuring taxable income, could respond to adoption of the proposal by adopting comparable provisions. Because most of our trading partners have both higher tariffs and higher income tax rates than we do, U.S. exports could be disproportionately affected by such retaliation.

Proposal to Increase Excise Tax Rate on Wine

Background

Under current law, different rates of Federal excise tax are imposed on different categories of wine. The different categories are determined by the alcohol content and carbonation of the wines. Specifically, the schedule of Federal excise taxes on wines is as follows: $0.17 per gallon on still wines containing not more than 14 percent alcohol; $0.67 per gallon on still wines containing more than 14 percent and not more than 21 percent alcohol; $2.25 per gallon on still wines containing more than 21 percent and not more than 24 percent alcohol; $2.40 per gallon on artificially carbonated wines; and $3.40 per gallon on champagne and other sparkling wines. The rate of Federal excise tax on beer is $0.29 per gallon (a lower rate applies to certain small brewers). Most beers contain between 3 percent and 5 percent alcohol. The rate of Federal excise tax on distilled spirits is $12.50 per proof gallon.

Adjusted for differences in alcohol content, most still wines are subject to a substantially lower rate of Federal excise tax than beer and distilled spirits. For example, the same amount of alcohol is contained in one gallon of distilled spirits containing 50 percent alcohol; 12-1/2 gallons of beer containing 4 percent alcohol; 2-1/2 gallons of still wine containing 20 percent alcohol; and 4 gallons of still wine containing 12-1/2 percent alcohol. The respective Federal excise taxes on these beverages are $12.50 on the distilled spirits; $3.63 on the beer; $1.68 on the still wine containing 20 percent alcohol; and $0.68 on the still wine containing 12-1/2 percent alcohol.

Description of the Proposal

Under the Chairman's Plan, the rate of Federal excise tax on still wines containing not more than 21 percent alcohol would be increased to the Federal excise tax rate currently imposed on beer (on an alcohol content equivalence basis). Our preliminary estimate is that the proposal would raise Federal revenues by approximately $1.5 billion over fiscal years 1986-1991.

Discussion

As discussed earlier, a principal justification for imposing a Federal excise tax on wine and other alcoholic beverages is that the consumption of alcoholic beverages produces social costs not reflected in their market price. This rationale would suggest that the amount of tax should bear a relationship to the amount of alcohol contained in the beverage and that, after adjustment for differences in alcohol content, the tax rates on different alcoholic beverages should not be widely dissimilar.

The external social costs resulting from the consumption of alcoholic beverages may, however, vary depending upon the type of alcoholic beverage. To the extent there is clear evidence of such variance, some differences in excise tax rates may be appropriate.

Proposal to Adjust Federal Excise Tax Rates to Reflect Price Changes

Background

Under current law, the Federal excise taxes on alcoholic beverages, tobacco products, gasoline, diesel fuels, special motor fuels, and aviation fuels are based on the quantity of goods sold, rather than on the value of the goods sold. The tax rates are not adjusted for inflation.

Description of Proposal

The Chairman's Plan would provide for the adjustment of Federal excise tax rates on alcoholic beverages, tobacco products, gasoline, diesel fuel, special motor fuels, and aviation fuels to reflect changes in prices. The rates would not, however, be permitted to fall below the levels of current law. The proposal would raise Federal revenues by approximately $9.7 billion over fiscal years 1986-1991.

Discussion

As noted above, we believe that excise taxes may be justified to internalize external costs associated with producing or consuming the good, to cover government benefits to the users of the good, or to raise revenue with minimal distortion of economic behavior. Setting excise tax rates at a level that will achieve the intended goal of the tax requires identification and measurement of associated external costs or user benefits, as well as the responsiveness of consumers of the good to price (and therefore excise tax) changes.

These are not simple tasks, nor are they free of controversy about the proper definition and measurement of associated costs and benefits. Although any inflation rate adjustment will provide an imperfect means of correcting excise tax rates for changes in costs or benefits associated with the use of taxed goods, we believe that the alternative of having fixed rates slowly eroded by inflation is on balance undesirable. We thus support the Chairman's proposal.

As inflation has occurred and the prices of taxed goods have tended to rise, the amount of unit based (as opposed to value based) Federal excise taxes has fallen, both in constant dollar terms and as a percentage of the price of the goods. The decline in the rate of Federal excise taxes in constant dollar terms has been particularly pronounced in the case of excise taxes on alcoholic beverages. Although the Federal excise tax on distilled spirits was increased in 1985 from $10.50 per proof gallon to $12.50 per proof gallon, the rate had not previously been increased since 1951. Similarly, the Federal excise taxes on beer and wines have not been increased since 1951. If the excise taxes on these products had increased by the same percentage as consumer prices (314 percent), the excise taxes on distilled spirits, beer, and wine (containing not more than 14 percent alcohol) would have risen between 1951 and 1985 from $10.50 to $43.48 per proof gallon in the case of distilled spirits; from $0.29 to $1.20 per gallon in the case of beer; and from $0.17 to $0.70 per gallon in the case of wine.

The Chairman's Plan does not describe the manner in which Federal excise tax rates would be adjusted to reflect price changes. Such adjustment could be made by changing to an _ad valorem_ basis for the taxes, so that they reflect the price of the products sold rather than the quantity of the products sold. Alternatively, the adjustment could be made by leaving the basis of the tax unchanged and periodically adjusting the rate of tax by an appropriate price index. We recommend the latter alternative. Changing to an _ad valorem_ basis would require significant changes in administrative practice and raise compliance problems, for example, through the manipulation of intercompany transfer prices.

Conclusion

If sufficient base-broadening measures are not adopted, and if the President's tax reform objectives are otherwise met, the Administration could support excise and related tax proposals as part of a revenue-neutral tax reform bill, provided that a justification exists for increasing the level of the particular tax. As I have indicated in my testimony, the factors that may justify an increase in particular excise taxes are the existence of external costs associated with the production or consumption of the taxed good or service, the function of the tax as a surrogate user fee for goods or services supplied by the Federal government, and the fact that a particular excise tax may cause minimal distortion of economic behavior where demand for the taxed good is relatively unresponsive to changes in price.

Appendix A

Estimated Federal Excise Tax Collections for Fiscal Year 1986

General Fund Revenues	$ Millions
A. Alcohol Excise Taxes	
1. Distilled spirits	4,110
2. Wines	276
3. Beer	1,605
4. Alcohol occupational taxes (brewers, dealers)	21
Refunds	-124
Total	5,888
B. Tobacco	4,609
C. Manufacturers' Excise Taxes	
1. Gasoline	1
2. Firearms, shells and cartridges	92
3. Pistols and revolvers	24
4. Bows and arrows	9
5. Gas guzzler	58
6. Windfall profit	4,161*
Refunds	-90
Total	4,255
D. Miscellaneous Excise Taxes	
1. General and toll telephone and teletype service	2,327
2. Wagers taxes, including occupational taxes	7
3. Employee pension plans	14
4. Tax on foundations	127
5. Foreign insurance policies	80
Refunds	-20
Total	2,535
E. Other	153
Subtotal, General Fund	17,440

Trust Fund Revenues	$ Millions
F. Highway Trust Fund	
1. Gasoline	8,730
2. Trucks, buses, and trailers	1,198
3. Tires, innertubes and tread rubber	251
4. Diesel fuel used on highways	2,618
5. Use-tax on certain vehicles	406
Refunds	-180
Total	13,022

G. Airport and Airway Trust Fund

1. Transportation of persons	2,607
2. Waybill tax	144
3. Tax on fuel	114
4. International departure tax	94
Refunds	-5
Total	2,954
H. Aquatic Resources Trust Fund	203
I. Black Lung Disability Insurance Trust Fund	546
J. Inland Waterway Trust Fund	51
K. Hazardous Substances Trust Fund	427
Subtotal, Trust Funds	17,203
Total Excise Taxes	34,643

Office of the Secretary of the Treasury
Office of Tax Analysis
April 17, 1986

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

* This estimate was based on a forecast of oil prices made in December for the FY 1987 budget. The forecast for calendar year 1986, for example, was $24.70 a barrel. At a price below $16.50 a barrel, there would be no windfall profit tax liability.

Appendix B

Estimated Customs' Duties for Selected Commodity Groups for Calendar Year 1985

	$ millions
Food	473
Alcoholic beverages	127
Tobacco	64
Crude oil & petroleum products	213
Chemicals	306
Pharmaceuticals	29
Tires	73
Plywood	41
Paper	47
Textiles yarns and fabrics	494
Glass	192
Iron & steel mill products	492
Non-ferrous metals	75
Metal manufactures	253
Machinery	2,861
Transportation equipment	1,785
Apparel	3,028
Footwear	572
Scientific instruments	186
Toys and games	187
Total	11,498

Office of the Secretary of the Treasury April 14, 1986
Office of Tax Analysis

TREASURY NEWS

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FOR RELEASE UPON DELIVERY
Expected at 1:00 p.m.
April 22, 1986

TESTIMONY OF THE HONORABLE
GEORGE D. GOULD
UNDER SECRETARY FOR FINANCE
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON COMMERCE,
CONSUMER, AND MONETARY AFFAIRS
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
U.S. HOUSE OF REPRESENTATIVES
TUESDAY, APRIL 22, 1986

Mr. Chairman and Members of the Subcommittee:

I commend the Chairman for calling these valuable hearings, and I appreciate the opportunity to take part.

The subjects you are exploring are of great consequence. All of us are well aware that the Congressional impasse on the renovation of half-century old banking laws leaves a large segment of the American financial services industry operating in (and around) an antiquated legal construction.

This inaction is not just a problem for our nation's banking organizations. We are hurting their customers, too, including consumers and savers of modest means. The old notion of how to serve consumers persists among some of your colleagues: They seek to dictate rules ordering depositories to do this or that for their customers, rules of increasing specificity that always are seeking to catch up with innovation -- but which are doomed to remain at least one step behind the market and technology.

Meanwhile, the opportunity to help consumers by authorizing more firms to compete for the public's business through increased services lies dormant under the weight of old laws.

America's businesses and productive capacity suffer as well. The efficient movement of capital always has been critical for economic growth and development. Anyone concerned about American entrepreneurship, our trade position, or our technological advancement cannot ignore the financial network that is supposed to channel investment effectively. I believe it is a woeful mistake to let our banking system fall behind the changes taking place in the industries it should serve. Our international competitors are not so short-sighted.

The agenda you outlined in your letter of invitation is wide ranging. My recent statements before the House and Senate Banking Committees address some of your topics of inquiry, especially the clear need for the Congress to free banking organizations to evolve with their marketplace.

Today, I would like first to summarize our position on one of the key subjects you are exploring: The need for banking organizations to offer some securities services. We have commented on this topic at length, but its importance merits brief restatement. Then I would like to devote the rest of my remarks to another significant issue for this Subcommittee, one that seems to cut across many of the items on your agenda: regulating access to the payments system.

I. Securities Services for Banking Organizations

The spectacular rise of active securities markets for what were once illiquid assets has challenged the heart of banks' traditional lending businesses -- whether in commercial and industrial loans, mortgages, or now even car loans, and computer lease and credit card receivables. In addition, the inability of banks to offer mutual fund services handicaps their ability to serve and compete for many of their traditional depository customers.

Much has been written from both legal and economic perspectives on whether the Glass-Steagall Act, part of the Banking Act of 1933, is, after more than fifty years of change, still appropriate. Perhaps a political perspective is most revealing: Time and again strong lobbies, focusing on their narrow protectionist interests, have kept the banks' services hemmed in. The banks lose. Their customers lose. The public good loses.

In recognition of this reality, we have urged the Congress to test incrementally the precepts of Glass-Steagall. We could make a start by clarifying the authority of banking organizations to compete in familiar and relatively low-risk securities businesses like underwriting and dealing in commercial paper, municipal revenue bonds, and mortgage-backed securities. We also need to enable banks to compete for their traditional middle-income customers by offering mutual funds. Then the Congress could evaluate the industry's experience and take additional steps later, if beneficial.

The Subcommittee is familiar with our argument and will hear more from Comptroller of the Currency Clarke on this subject, so I will not belabor the point today. I would certainly be pleased, however, to explore this issue further with the Subcommittee during the question period.

II. The Payments System

A. How the Payments System Relates to Your Inquiry

The payments system is a frequently mentioned but rarely understood point of dispute in the debate over the separation of banking from commerce. In particular, it relates to the question of who should be able to own fully regulated depository institutions. Some of the opponents of consumer banks, of unitary thrift holding companies, and even of expanded services for bank holding companies contend that these competitive developments put the payments system at risk.

I believe it is time to clarify and discuss the concerns about the payments system by asking how the new owners of fully regulated consumer banks or thrifts threaten it. If we can isolate specific dangers, perhaps we can determine a way to alleviate them through regulation. Appropriate regulation would certainly be preferable to prohibiting commercial and other firms from owning banks and thrifts, because there are real costs to foreclosing these new owners. The costs of prohibition include: (1) fewer investors of capital in banks and thrifts; (2) less competition; (3) less transference of management and marketing skills acquired in other businesses; and (4) less innovation through synergistic development of services for consumers and other customers. (Indeed, at this point a total prohibition on depository ownership by commercial, industrial, and "inappropriate" financial firms would require major divestitures.)

B. What is the Payments System?

What is the payments system?

It's the mechanism through which funds are transferred between payers and receivers throughout the economy. When you write a check, the payments system ensures that the person to whom it is payable gets his or her money. When a company pays salaries through "direct deposit", the payments system makes certain the employees' bank accounts are credited with the funds. When you use a credit card at a store, the payments system ensures that the retailer gets the money from your bank. And so on. The system is fundamental to the efficient operation of a market economy.

C. Who Runs the Payments System and How Does It Work?

Depository institutions (e.g., banks, thrifts, and credit unions) provide "retail" access to the payments system. The system enables them to exchange checks and electronic transfers among one another through private arrangements and the Federal Reserve.

There are two major "wholesale" electronic payment systems in the United States. The primary wholesale system is FedWire, an electronic funds transfer mechanism of the Federal Reserve System. Banks and other depositories send and receive payments to one another over FedWire throughout the day. The average daily volume of transfers totals approximately 150,000, involving about $400 billion.

When a bank makes a transfer over FedWire, the payment is final: The bank instructs the Fed to transfer money from the sender's account to the receiver's account at the Federal Reserve, and the receiving bank then gets an irrevocable credit for its funds.

It is common for banks to overdraft their own clearing accounts at the Federal Reserve during the day as they transfer funds to other parties. Some flexibility on overdrafts is necessary because the speed and efficiency of transactions would be slowed considerably if banks were only allowed to make transfers against collected balances; it is difficult to anticipate the timing of receipts and disbursements within one day. At the end of each day, however, the banks must reestablish their reserve balances with their Federal Reserve Banks.

If a sending bank could not cover all its transfers at the end of a day (i.e., if it failed), the Federal Reserve could not revoke the credit it gave the receiving depository. The Fed would still stand behind the sender banks' payments for the day (and would become a creditor of that failed bank).

The second major electronic payments system in the U.S. is called CHIPS (Clearing House Interbank Payment System). CHIPS is privately owned and operated by the New York Clearing House Association. It currently has about 150 U.S. and foreign bank participants, representing over 40 nations. On average, CHIPS handles about 90,000 transfers each day, involving well over $200 billion.

Unlike the FedWire, a CHIPS transfer does not result in the actual movement of funds until the end of the day. Throughout the day, participating banks send payment messages, which they must settle among one another late in the afternoon. Participants that have sent more payments than they have received are required to transfer funds over FedWire to the CHIPS settlement account at the New York Federal Reserve Bank to cover the sums they owe.

When the amounts sent equal the amount owed, settlement is completed by transfers to participants.

The banks participating in CHIPS are required to monitor their exposure to other banks. The system monitors each bank's total overdraft on all the banks in the system.

CHIPS appears able to remain competitive with FedWire, despite its lack of an irrevocable credit upon transfer, for three major reasons: (1) it charges less for same-day settlement service; (2) the participants by and large trust one another to make good on payments; and (3) the participants have a strong interest in maintaining a viable competitor to FedWire.

D. Who has Access to the Payments System?

The Depository Institutions Deregulation and Monetary Control Act of 1980 allowed all depository institutions (as defined by section 19(b) of the Federal Reserve Act) to make direct use of the Federal Reserve's payments facilities. Prior to that Act, only banks that were members of the Federal Reserve and a small number of other institutions could obtain the Fed's payment services directly.

The 1980 Act was supposed to improve the Fed's ability to conduct monetary policy by permitting it to impose reserve requirements on all U.S. depositories. In return, all depositories gained access to the payments system. Congress intended this wider access to enable all depositories to offer better, more efficient, and less costly services to their customers. Indeed, during the legislative debate, both Chairman Barnard and then-Chairman Proxmire spoke about the benefits of greater competition in the payments system.

The 1980 Act also instructed the Federal Reserve to charge users for these services. These charges were to enable other providers of payment services to compete with the Fed. As it has turned out, the Fed has continued to play the dominant role in the payments system because it establishes the groundrules that govern the most important aspects of the system.

For example, the Fed's assurance of final payment on any transfer over FedWire has given it a notable edge over would-be electronic funds transfer competitors. Other systems can transfer payments, but in the end the Federal Reserve controls their all-important settlement. Some private sector domestic competitors, such as BankWire, simply could not compete and have fallen by the wayside.

The Federal Reserve's dominion over the payments system has had some important effects. First, the fees for payment system services provide a hefty independent income to the Fed (revenues which are provided to the Treasury after expenses). Second, it gives the Fed a significant tool for exerting indirect control over the full range of depositories that now have access to the payments system.

E. New Concerns About Access to the Payments System

A few years after all depository institutions gained access to the Federal Reserve's payments system, some commentators raised concerns about who should own these depositories. In particular, these commentators opposed commercial firms' ownership of consumer banks or thrifts. Non-financial firms have been free to own a thrift for decades; consumer (or nonbank) banks have become increasingly active and evident since 1980.

To be frank, the nature of the risk posed by these owners has not always been portrayed with precision. The difficulty in doing so may be due in part to the complexity of the payments system subject.

I would like to start to identify these supposed problems so we all can discuss whether they should supercede the competitive (and capital infusion) benefits of broader ownership of fully regulated depositories.

So far, I have been able to discern four somewhat interrelated payments system concerns: (1) The "new" owners will be more likely than "old" bank holding companies to misuse their regulated depository; (2) The "new" owners will not intervene to save their depositories if the depositories are in trouble; (3) The "franchise value" of the payments system must be preserved for banks and thrifts in order to compensate them for the "costs" of regulation; and (4) Broader ownership of depositories will dilute the regulators control over depositories and the financial system. Let me comment on each point.

1. New Owners are More Likely to Misuse Their Depositories

One concern is that the "new" owners of consumer banks and thrifts -- whether a commercial or industrial company or a financial firm outside the bank holding company universe -- are more likely to misuse their depositories. This misuse, if it occurred, could injure the payments system of which the depositories are a part.

This concern suggests that bank and thrift executives are in some sense different from (and more scrupulous than) executives of a retail or industrial company that might own a depository. Even if the depository is fully regulated, so the argument runs, the temptation for a troubled parent to draw on its banks will overcome any legal limits. Supposedly, the managers of the depository would fail to exercise an independent credit judgment. There is a fear that the "captive" bank could incur substantial daylight overdrafts (loans), on behalf of its weakened owner (or affiliates), and then the bank would default when its affiliates fail to repay the overdrafts. The advocates of this point seem to ignore the alternative case -- that it may be handy to have a healthy owner around to infuse capital into a weak bank.

In addition to some questionable assumptions about the character of managers in different businesses, this "misuse hypothesis" appears to postulate substantial regulatory failure and fraud. This despite a battery of laws and procedures in place to prevent and penalize such abuse.

First, bank advances on behalf of an affiliate are, in effect, loans covered by the strictures of Section 23A of the Federal Reserve Act. Section 23A limits affiliate loans by insured banks to 10 percent of the bank's capital for any one affiliate and 20 percent for all affiliates as a group.*/ Thus, if a bank has 5 percent capital, its daylight overdraft on behalf of its affiliate cannot exceed one-half of 1 percent of the bank's assets, and overdrafts to all affiliates cannot exceed 1 percent.

Purchases of assets from affiliates, investments in the securities of affiliates, and guarantees issued on behalf of affiliates are also subject to these limits. In addition, a loan to a third party, where the proceeds are used for the benefit of an affiliate or are transferred to it, is considered a loan to the affiliate itself for purposes of these restrictions.

Even within these limits, Section 23A requires all loans to affiliates to be fully secured by high quality collateral. If an insured bank's directors, officers, and employees violate Section 23A, they can be personally subject to severe penalties, including substantial civil fines.

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*/ Of course a consumer bank would be prohibited from even making such a loan, because it would be a commercial loan. Under present law, a nonbank bank (of which consumer banks are a subset) can either make commercial loans or accept demand deposits, but not both. If it did, the bank would fall under the Bank Holding Company Act, which severely restricts the activities of the holding company owner and its affiliates.

Second, the depository must adhere to numerous independent regulatory requirements pertaining to safety and soundness. These requirements are monitored by examinations, including on-site reviews of payments activities. If a depository's performance is deficient, its regulators possess broad powers to rectify the situation. These powers include the authority to remove directors, officers, and employees and to impose monetary penalties.

Third, the Federal Reserve requires depositories and payments systems to establish a number of safeguards to limit the risks posed by daylight overdrafts. These protections apply to any depository that uses electronic funds transfer systems that process settlements through the Fed's facilities.

The most significant new safeguards are the "bilateral net credit limits" and "sender net debit caps." A bilateral limit sets a maximum amount that a depository is willing to receive from another depository; it is, in effect, a limit on a daylight line of credit and is subject to prudential credit standards. The bilateral limits apply to CHIPS and other private systems. FedWire's assurance of payment precludes the need for receivers to establish bilateral credit limits.

A sender net debit cap is a limit on a depository's total overdrafts within each system, e.g., FedWire and CHIPs, and also across all electronic funds transfer systems. A depository's daily net debit cap cannot exceed three times the depository's capital, and the cap on its average daily net debit for a two-week period cannot exceed twice the banks' capital. The board of directors of each depository must approve these caps after a self-rating process.

The Federal Reserve will monitor banks' consistency with these caps, will counsel any banks that exceed the limits, and may ultimately restrict the use of FedWire for banks that cannot operate properly within these procedures. In addition, the Federal Reserve is implementing other measures to protect itself from losses in the event a depository fails to cover a FedWire overdraft. These measures include collateral requirements in certain situations.

To date, there is no evidence of payments system abuse by commercial firms that own nonbank banks or thrifts. To the contrary, the affiliation between a bank and a commercial firm reduced risk to the payments system in 1981, when Chrysler Corporation received federal and state approval to form a bank to obtain payments services directly from the Federal Reserve. Commercial banks had refused to accept Chrysler drafts drawn to collect payments from dealers, so Chrysler had to form a bank to keep the payments flowing.

I do not wish to suggest that we would be unwilling to add to these affiliate protections, if someone can specify particular dangers to remedy. In fact, I consider it far more fruitful to develop sensible regulation of new owners of depositories than to try to ban their involvement. Even if one agrees with the prohibition approach, which I do not, one has to contend with the numerous unitary thrift holding companies and nonbank banks already in existence.

2. New Owners Will Walk Away from A Troubled Depository

The second contention leveled against commercial and other non-bank holding company owners of depositories is that these owners will be prone to "walk away" from their depository if it is in trouble. The advocates of this point believe these parents will not be as reliable as bank holding companies because these new owners' depositories will supposedly be a less significant aspect of their overall business.

We would not deny that depositories owned by bank or multiple thrift holding companies are the cornerstones of their businesses. But it is a substantial leap of logic to move from that point to a finding that other owners will increase risk to the payments system because they will refuse to assist their depositories.

First, these new parents may be just as likely to step in to assist their depositories if they are in trouble, both because the depositories are of value to them and because the parents will want to avoid a besmirched business reputation. Indeed, a number of commercial firms have sought to buy and recapitalize distressed thrifts because of their value. These parents, with more diversified operations, may be better positioned than a bank holding company to infuse capital into an ailing depository.

Second, even if one assumes the new parents will let their depositories fail, those depositories will be no worse off than the thousands of banks and thrifts without a deep pocket parent. They will still be fully regulated. They will still be subject to capital directives and other supervisory action if their performance slips. Only now they will have the option, and I would think the probability, of getting assistance first from their commercial or industrial owners. To be worse off, these depositories would have to be susceptible to misuse from their owners, the concern I just addressed.

3. Preserving the Franchise Value of the Payments System for Banks

The third argument made against expanding the ownership of depositories is that the present owners need an exclusive franchise. They are supposed to be in some sense more deserving of a position as the sole sellers of access to the payments system.

Some proponents of this view maintain that these benefits "pay" for the regulatory limits on bank holding company activities. Their argument sees profits stemming not only from the direct payments services, but also from ancillary fee activities -- such as charges for bad or returned checks. And the franchise protected against competition includes the benefits from delaying the availability of funds from deposited checks.

I am uncomfortable with "unfair competition" rationales, most particularly when "fairness" is determined by a firm that would lose business to competition. I am no more comfortable with the prospect of regulators rationing business. Certainly, the franchise to charge high service fees is not one many of us would wish to preserve.

A significant purpose of the 1980 Act was to improve access to the payments system, so as to increase competition among suppliers of the service. Indeed, the importance of competition in this area was then reaffirmed by a 1984 report of this Committee that studied the effects of the 1980 Act on the payments mechanism.

Moreover, any new owner of an insured bank or thrift would still have its depository subject to the full measure of regulation and supervision, including its "costs". Indeed, the logic of preserving this business service for existing banks would lead us to refuse to charter new depositories, regardless of who owns them.

I, too, would like bank holding companies to be free to compete in more financial activities. My motivation, however, is to offer more competitive services to the public, not just to enhance banks' financial strength. I certainly cannot condone anti-competitive protectionism of bank holding companies in the payment services businesses just because they are enduring some anti-competitive barriers. Delaying the penetration of anti-competitive barriers until all firms attain some theoretical state of equality is a formula for justifying an inefficient status quo and poor customer service. Neither society nor individuals should have to pay more for check, credit card, and other payment services when new entrants want to fight for the business with lower prices.

4. <u>Regulators' Control Over the Owners of Depositories</u>

The fourth payments system issue may be the most significant concern for some regulators. I believe they hold an honest and deepfelt notion that expanded ownership of depositories will undermine their ability to discharge some responsibilities fully. Of course the regulators would still hold full supervisory sway over the underlying depository. But under present law, the

Federal Reserve would not also regulate the owner at the holding company level -- "the second bite at the apple". And the owner, if it were a large commercial or industrial firm, would not be familiar with the regulatory relationship to which even the biggest and most powerful bank holding companies have grown accustomed.

I label this the "club-club" concern. The first "club" concern is that these new owners will be more difficult to communicate with because they are not members of the business fraternity: I sense that the regulators want to ward off these new owners, whatever the competitive benefits, because they are not part of a familiar executive group with understood mores. Perhaps this suspicion also feeds the concern I discussed earlier -- that the new owners are more likely to violate the affiliate restrictions and other rules.

The second "club" refers to the regulatory stick, which for consumer bank owners does not exist at the holding company level. Some regulators seem to want that "extra" lever, a regulatory buffer beyond the complete regulation of the depository. It is true that most large banks are owned by holding companies. But most banks, especially smaller ones, are not. That second layer of regulation is already the exception, not the rule.

This concern is a difficult one to analyze. I recognize that the regulators' motivation is to serve the public good by protecting the financial system. They do an excellent job under difficult circumstances. But I believe we must be careful about accepting without question the interest of professional, expert regulators to control their markets. This interest must be balanced against the benefits of more diverse ownership and active competition.

The subject of regulatory control obviously involves some important precepts regarding the role of administrative agencies. Certainly we want to protect the payments system. Certainly we should regulate and examine the depositories that have access to it. Certainly we should regulate the affiliations between the depository and its owner. But do we really want to prohibit certain owners of depositories simply because they cannot be "controlled" in some generalized meaning of the word? For what purposes does this power really exist, and do we wish to accept them without inquiry?

I would submit the government should have something more specific in mind when it comes to protecting the payments system.

III. Conclusion

My prime purpose today has been to encourage greater understanding and analysis of the supposed risks to the payments system allegedly posed by a broader set of depository institution owners. It is not enough simply to say that protection of the payments system demands that we shut off or even roll back certain businesses from owning fully regulated depositories. We need to ask why. And we need to evaluate the answers we get.

I know this Subcommittee shares this approach, because it never has been afraid to pose the hard questions about our banking laws. The payments system is not an easy subject to master. Perhaps my remarks can begin to unmask some of its mysteries so we can understand its importance to policy.

My remarks are also an invitation. Others can supplement, refine, and improve on my analysis. I welcome that process. It is the only way we will fairly determine whether anti-competitive restraints on depository ownership have a beneficial purpose. I have yet to be persuaded of the advantages of these restrictions.

I also welcome a discussion of ways we might improve the regulation of depositories owned by a diversity of firms. Some consumer bank bills have called for a higher capital requirement. We may also consider a tightening of affiliate restrictions or requiring specific reports by the parent. Much can be done in the world of safety and soundness regulation that falls short of prohibition.

I look forward to working with this Subcommittee on this and other matters as you inquire into the state of our financial institution laws. The Administration shares your interest in revamping these laws for the modern era. We will work with you to hasten that statutory evolution.

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

TREASURY NEWS

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

FOR IMMEDIATE RELEASE April 21, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,005 million of 13-week bills and for $7,008 million of 26-week bills, both to be issued on April 24, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 24, 1986			:	26-week bills maturing October 23, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	5.84% a/	6.01%	98.524	:	5.84%	6.10%	97.048
High	5.87%	6.04%	98.516	:	5.88%	6.15%	97.027
Average	5.86%	6.03%	98.519	:	5.87%	6.13%	97.032

a/ Excepting 1 tender of $3,590,000.

Tenders at the high discount rate for the 13-week bills were allotted 47%.
Tenders at the high discount rate for the 26-week bills were allotted 58%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 41,365	$ 41,365	:	$ 22,960	$ 22,960
New York	22,169,430	5,969,760	:	18,819,700	5,368,300
Philadelphia	34,035	34,035	:	15,605	15,605
Cleveland	122,540	101,340	:	19,260	19,260
Richmond	34,705	34,705	:	32,755	32,755
Atlanta	40,160	40,160	:	26,600	26,600
Chicago	1,646,215	169,185	:	1,614,720	476,320
St. Louis	86,340	61,280	:	74,440	48,440
Minneapolis	36,945	11,945	:	34,250	25,850
Kansas City	51,670	51,670	:	36,075	36,075
Dallas	43,210	40,560	:	30,055	27,955
San Francisco	1,451,315	92,755	:	1,362,520	524,340
Treasury	356,275	356,275	:	383,770	383,770
TOTALS	$26,114,205	$7,005,035	:	$22,472,710	$7,008,230
Type					
Competitive	$23,259,710	$4,150,540	:	$19,555,470	$4,090,990
Noncompetitive	1,060,675	1,060,675	:	815,725	815,725
Subtotal, Public	$24,320,385	$5,211,215	:	$20,371,195	$4,906,715
Federal Reserve	1,651,235	1,651,235	:	1,650,000	1,650,000
Foreign Official Institutions	142,585	142,585	:	451,515	451,515
TOTALS	$26,114,205	$7,005,035	:	$22,472,710	$7,008,230

An additional $116,115 thousand of 13-week bills and an additional $377,885 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. April 22, 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 May 1, 1986. This offering will result in a paydown for the Treasury of about $400 million, as the maturing bills are outstanding in the amount of $14,403 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 Daylight Saving time, Monday, April 28, 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 January 30, 1986, and to mature July 31, 1986 (CUSIP No. 912794 KY 9), currently outstanding in the amount of $7,238 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $7,000 million, representing an additional amount of bills dated October 31, 1985, and to mature October 30, 1986 (CUSIP No. 912794 KS 2), currently outstanding in the amount of $8,316 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 May 1, 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 $1,167 million as agents for foreign and international monetary authorities, and $3,348 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 Release Upon Delivery
Expected at 11:30 a.m.

Remarks by
Secretary of the Treasury
James A. Baker, III
At the United States Chamber of Commerce
International Forum
Chamber of Commerce Building
Washington, D.C.
April 23, 1986

I'm delighted to have this opportunity to give you an accounting of where the United States stands before the Tokyo Summit.

We and our Summit partners have a common stake in almost every aspect of international economic life. We will discuss goals nations should set for their domestic economies and better ways to harmonize those individual efforts.

As the world's leading economy, the United States must recognize the responsibilities that go along with that position. But the tasks we face are collective in nature and that is why we seek cooperation, a partnership if you will, with the major industrial countries to promote international economic growth.

The economic environment in the industrial countries has improved significantly since the last Summit. The dramatic decline in oil prices should add as much as a point to real GNP growth in West Germany this year and the rest of Europe should benefit equally.

We expect inflation in the United States and the rest of our Summit partners' economies to be cut by up to two points. West Germany and Japan could actually see zero or negative inflation.

B-554

Basic improvement in growth and inflation in other countries prompted the G-5 nations -- Great Britain, West Germany, Japan, France and the United States -- to agree that some orderly appreciation of the major non-dollar currencies was desirable. Since the meeting of the G-5 representatives in New York last September the dollar has declined, in generally orderly conditions, by 24 percent against the deutschemark, and 30 percent against the yen. This should improve the competitive outlook for U.S. businesses, both at home and abroad.

Interest rates are down to their lowest levels in years. The recent series of discount rate cuts by the central banks of Europe, Japan and the U.S. reinforce the favorable effects of lower oil prices and are a sign of improved international cooperation.

With the fall in oil prices and the decline in the value of the dollar, we can reasonably expect the U.S. trade and current account deficits to gradually diminish. But many politicians do not have such learned patience, particularly in an election year. The advocates of restrictive trade policies are already raising their decibel level on Capitol Hill.

At the same time, threats of new import barriers are being echoed in Europe. With the virus of protectionism spreading, it is imperative that the Summit countries seek a remedy for this disease. Only by addressing broader issues together do we have any chance of finding a solution to the perennial problems of trade imbalances.

The sharp drop in oil prices coupled with exchange rate changes and stronger growth abroad should reduce the trade deficit to $125 billion in 1986. By the end of 1987, we expect both the trade and current account deficits to slip below the $100 billion level.

But this is only good news for the near future. Our economic forecasts indicate that by the end of 1987, the exchange rate movements to date will have taken their full effect, and the "growth gap" will reassert itself. This will cause our trade and current account deficits to balloon once again.

Exchange rate changes alone will not reduce trade and current account imbalances. The major industrial countries should place greaer emphasis on achieving more balanced growth with the United States and each other.

For Europe, a prerequisite to stronger, more sustained growth continues to be removal of structural rigidities. These include high minimum wages, high marginal tax rates, and other policies that impede the efficient use of resources. It's worth remembering that the flexibility of the U.S. economy added nearly ten million new jobs in the last three years while European job creation remained flat.

Japan also faces structural barriers to more rapid growth, especially growth of domestic demand which is crucial to the adjustment of Japan's large external imbalance. Increased demand should be enhanced by the drop in oil prices and specific policies undertaken to strengthen domestic investment and consumption.

To promote more balanced trading patterns and improve exchange rate stability the industrial nations need to develop arrangements to foster the closer coordination of economic and monetary policies.

The current system of floating rates has provided a flexible framework for dealing with a number of global economic shocks. While the system has strengths, it also has weaknesses. There is a clear need for improvement, especially to deal with excessive exchange rate volatility and large persistent trade imbalances.

The President has asked me to determine by the end of the year whether an international monetary conference or meeting should be held. We have not made any decisions on possible improvements in the system or on the desirability of an international conference. But we will be interested in progress on monetary issues at the Summit.

Our goals for non-inflationary growth are not limited to the major industrial countries. Without stronger growth, there can be no solution to the debt problem. Debtor countries must be able to accumulate resources -- and export earnings -- at a faster pace than they are accumulating debt.

The debt initiative that we proposed last fall is designed to accomplish this objective based on the adoption of growth-oriented reforms by the debtor nations and increased financial support from the international financial institutions and the commercial banks. This initiative has received strong support from the international community and is now being implemented through individual debtor's negotiations with the International Monetary Fund and the World Bank.

An improved global economic environment will contribute to growth in the debtor countries and help reduce their debt service repayments through lower interest rates, decreased oil bills, and increased exports to the expanding economies of industrialized nations.

To take better advantage of these developments a number of debtor nations are moving to privatize state-run businesses, freeing capital and labor for more productive enterprises and allowing market forces to set exchange rates. Not too long ago conventional wisdom held that capitalism could only exploit less developed countries. I am confident that they will prove that it can emancipate them from economic stagnation.

As Adam Smith observed, the system of free commerce promotes "order and good government and, with them, the liberty and security of individuals." That system promotes growth and provides for the equality of opportunity -- so Marx's working class can become a middle or upper class.

In the concert of the West there is an inevitable dissonance that may confuse some observers. We have our disagreements and we will address them at the Summit.

Yet our nations remain great examples for others, despite our often well-advertised problems. The rest of the world looks to us, the great industrial democracies, for the keys to expanding prosperity. Socialism has not satisfied this goal and it no longer suffices for the hopes and needs of mankind.

The Summit partners have different priorities and cultures, but similar political institutions -- democracy and free enterprise. Working together, we can serve the world well.

Thank you very much.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE April 23, 1986

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,752 million of $18,300 million of tenders received from the public for the 2-year notes, Series Y-1988, auctioned today. The notes will be issued April 30, 1986, and mature April 30, 1988.

The interest rate on the notes will be 6-5/8%. The range of accepted competitive bids, and the corresponding prices at the 6-5/8% interest rate are as follows:

	Yield	Price
Low	6.63%1/	99.991
High	6.73%	99.807
Average	6.68%	99.899

Tenders at the high yield were allotted 42%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 17,655	$ 17,655
New York	15,328,500	7,979,440
Philadelphia	20,350	20,350
Cleveland	45,460	45,460
Richmond	72,315	62,315
Atlanta	91,955	90,955
Chicago	1,557,700	972,700
St. Louis	89,455	73,455
Minneapolis	31,660	31,660
Kansas City	111,720	111,720
Dallas	21,225	21,225
San Francisco	907,680	320,680
Treasury	4,585	4,585
Totals	$18,300,260	$9,752,200

The $9,752 million of accepted tenders includes $740 million of noncompetitive tenders and $9,012 million of competitive tenders from the public.

In addition to the $9,752 million of tenders accepted in the auction process, $385 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,129 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/ Excepting 1 tender of $2,000,000.

B-555

TREASURY NEWS

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

Address of The Honorable Francis A. Keating, II
Assistant Secretary (Enforcement)
U.S. Department of the Treasury
At the
Fourth Annual Judicial Conference
Washington, D.C.

April 23, 1986

The Customs Role in Trade Enforcement and Facilitation

I'm grateful for the opportunity to address this distinguished group on a vital topic: that topic is the future of the U.S. Customs Service in commercial operations and enforcement.

My fellow panelist, Mr. Myles Ambrose, and I have differing views on a number of issues concerning this topic. But I can safely say that there is one matter on which we can agree: that decisions on priorities and resources are very difficult decisions indeed. This was certainly true when Mr. Ambrose was the Commissioner of Customs. And it is more than ever the case today.

The business of government has always been the need to make hard choices. And I don't have to remind anyone here of the severe resource constraints affecting our government right now. It is the pervasive atmosphere in which we must work. Of necessity, it sobers our judgment and colors all our decisions.

This reminds me of a quotation from one of our Presidents who, being a person who rarely spoke out, isn't often quoted. I refer to Calvin Coolidge, who observed that there is no achievement, and no satisfaction, quite like living within one's means. Our entire government has learned, all too painfully, how true these words are.

From the standpoint of the Treasury Department, we simply do not have the luxury of providing the Customs Service with all the resources we would like it to have for both its law enforcement and its trade facilitation functions. We recognize that both of these functions are essential. We also recognize that only by being innovative can we hope to achieve them both in these days of limited budgets.

Only by being innovative can we maximize the effectiveness of the resources we have. As much as we would like to, we cannot respond to all the demands for more Customs manpower, more Customs offices, and increased levels of services.

As many of you know, I have been the Assistant Secretary for Enforcement for about 90 days. That is not enough time to become deeply immersed in every issue confronting Treasury enforcement, or even the issues confronting the Customs Service alone. However, it is enough time to get a feel for what needs to be accomplished. And with respect to the latter, I want to share with you the conclusions that I have reached.

Of the many law enforcement missions of the Customs Service, three are paramount. These are drug interdiction, critical technology, and commercial fraud. One conclusion I have reached is that these will continue to be our enforcement priorities. We should not, and will not, reduce our commitments in these areas.

It is undeniably true that Customs has substantially built up its enforcement presence in these three areas since President Reagan's Administration began in 1981. There are compelling reasons why this has been done.

There are some things we cannot wish away. One is that our country faces a drug trafficking and drug abuse problem of staggering proportions. For this our society is, in so many ways, paying an intolerable price. We are paying in lost lives, lost productivity, and lost opportunity for our youth who fall prey to the temptations of drug abuse. We are paying in the violent crime that goes hand in hand with the drug trade and in the support that drugs give to criminal organizations. We are paying in the huge sums of dollars -- tens of billions -- lost in taxes evaded by the underground economy, and in dollars that go abroad to pay the enormous bill for our country's drug habit.

President Reagan has declared an all-out war on drugs and drug abuse. U.S. Customs will continue to fulfill its commitment to the President.

Operation Exodus, the Customs program to prevent the loss of our country's technological secrets, is of critical importance as well. Our strategic technology is the cornerstone of our country's military superiority. To allow it to be eroded by illegal exportations to the Eastern Bloc would be the height of folly. If we do, we will pay a cost far higher than what Exodus costs. We will pay in the form of higher defense budgets. Worse yet, we will pay in the form of compromising our national security itself.

A third enforcement priority, commercial fraud, is one that I personally will be giving a lot of attention. Enforcement of our country's trade laws is essential if we are to achieve President Reagan's goals in international trade policy. It is central to the overall mission of the Customs Service. It is critical to many sectors of our economy. And as a matter of trade policy, rigorous enforcement can ameliorate the demands for protectionist legislation. In short, our country's goals of free trade are meaningless unless there is also fair trade. For this, Customs, more than any other agency, must fulfill its mission.

I do not want to confine my emphasis to trade enforcement alone. Trade enforcement is only one element of the traditional Customs mission, which of course also includes trade facilitation and the collection of revenue.

With regard to these two functions, there is no denying that Customs has been faced with a challenging task. First, workload is increasing. To give you some examples, entries increased from approximately 6.1 million in 1976 to approximately 10.5 million in 1985. During that same time period, revenue collections increased from approximately $5 billion to $15 billion. The value of imports rose from $115 billion to $330 billion.

There is also no denying that, as many in the trade community have pointed out, Customs has reduced its staffing in some areas. For instance, Customs had approximately 1250 import specialists in 1976. We have approximately 1000 today. Where Customs has made reductions in staffing, it has done so in response to resource limitations and in response to the need to direct resources toward enforcement priorities. The largest resource reductions, however, have not been at the expense of trade facilitation, as some have suggested. They have occurred principally through the consolidation and streamlining of administrative functions and the elimination of overhead.

In the brief time I have been at Treasury, I have not had the opportunity to determine precisely which of the many elements in Customs commercial operations may need more resources. And I have not concluded that the present allocations of resources are optimal in every instance. But I have concluded two things: first, that this area of the Customs mission has in no sense been ignored, as some would assert. Second, I have concluded that any issues affecting the commercial operations function at Customs will be of the highest priority in my office.

With respect to my first conclusion, that Customs has given much attention to commercial operations, there are a number of points that can be made. One of them is the Automated Commercial System. The commitment here is unmistakable: Since 1983 Customs has invested more than 60 million dollars and 290 staff years in this system, which is really many systems all rolled into one. When they are all in place, Customs will be able to administer our trade laws better than it ever has before. ACS will improve our ability to protect the interests of U.S. trade policy without interfering with the flow of imported goods into the United States.

Just what is ACS? It is many things, too many to describe in detail here. And I am not professing to be an expert in the subject by any means. But I can tell you that the basic principle is using automation to collect and process commercial data quickly, efficiently, and cost-effectively. It is the application of these data to select for detailed attention the high risk cargo shipments. It is using the automated interfaces to reduce paperwork, eliminate delays and speed the overall processing of entries.

ACS will greatly increase the productivity of Customs employees. But it will also benefit the importing community, particularly those who tie into our systems so that data and information can be readily exchanged. Customs is working hard to market this electronic trade interface to brokers, importers, carriers, and port authorities. More than twenty brokers and importers are on the system now. They represent about 22% of the total Customs formal entries. Fifty more brokers, importers, and service centers are in the process of developing and testing the ACS linkage.

ACS has come a long way. Back in February of 1984, when Customs first implemented the system, there were 700 terminals processing a volume of 110,000 transactions each day. Today, we have 1666 terminals on line. We do 260,000 transactions each day, and these numbers are growing. To at least some extent, all Customs revenue and entry processing is now accomplished through ACS.

Because it helps Customs select the high risk shipments for detailed examination, ACS is a most useful enforcement tool. It is also a tool for trade facilitation: right now, we inspect less than 20% of all cargo, and 60% of entries need not be reviewed by an import specialist. Routine, low risk shipments speed through the system.

I do not want to leave anyone with the impression that we are looking to ACS to meet all of the challenges ahead in commercial operations.

Customs is doing many other things as well to improve its trade-related functions. An example is the intelligence capability that Customs has assembled and dedicated solely to the commercial fraud area. Until recent years, Customs intelligence was largely concerned with other enforcement matters. We now have a distinct intelligence capability to support Operation Tripwire, the Customs commercial fraud initiative, both at headquarters and in the field.

Customs also has fraud teams -- 41 of them -- to conduct the Tripwire investigations. These teams include special agents, inspectors, import specialists, and intelligence specialists. At headquarters, the Commercial Fraud Investigations Center tracks and monitors all major fraud cases.

In commercial fraud enforcement, there is an area in which we recognize a need for improvement, and that area is the training of Customs agents to conduct commercial fraud investigations. Last winter, Customs held a major conference in New Orleans to address this need. As a result, each of the seven regions are now following up with this effort. Even more important, Customs and another Treasury bureau, the Federal Law Enforcement Training Center at Glynco, Georgia, have collaborated on new training programs.

In short, we want to do everything we can to reverse a perception that unfortunately has grown over a number of years: the perception among agents that fraud cases are not as career-enhancing as investigations into drugs, money laundering, and critical technology diversions. From the Treasury and Customs management perspective, fraud cases should not and will not take a back seat to our other missions.

There is another change Customs has made to improve commercial enforcement. It is the Operational Analysis Staff, which is made up of senior import specialists and inspectors in the field. Their function is to identify irregular or suspicious commercial transactions based on their operational experience.

Customs auditors serve a similar function, in feeding into the ACS system the data on high risk shipments. This enables Customs to be more selective in its enforcement function, as I described earlier. Last fiscal year, over 28% of the total Customs audit resources were in direct support of the commercial fraud program.

All of these steps I have mentioned have done more than enhance commercial fraud enforcement. They have also enhanced facilitation. What is often overlooked is the additional benefit that comes from the initiatives Customs has spearheaded in Commercial fraud enforcement. They have enabled Customs to learn more, indeed much more, about fraud schemes and about commercial processing in general. From this knowledge, we are now able to bypass a great volume of entries and cargo with little or no processing. This, in my view, is what enhancing facilitation is all about.

And, to return to a topic I mentioned a moment ago, I am still considering the question of whether Customs commercial resources are now optimally allocated. I have not had the opportunity to reach a decision on this matter, but there are a few thoughts I want to leave with you.

First, the matter of commercial fraud enforcement is receiving attention at an extremely high level in this Administration. On February 14, Secretary Baker submitted to President Reagan a report on textile and apparel imports, in response to the President's request in his message accompanying his veto of the Textile and Apparel Trade Enforcement Act.

The report reached a number of significant conclusions. We don't have time to go into each of them. But two of these recommendations address commercial fraud in general, and I would like to highlight them specifically.

First, the Secretary told the President that the Customs Commercial Fraud Enforcement Program should be maintained at a high priority level, so that it, along with drug enforcement and Exodus, is among the highest enforcement priorities.

Second, the Secretary recommended that the Attorney General communicate to all U.S. Attorneys that prosecution of textile and other commercial fraud cases should be designated as a high priority, as well.

The White House has made this report public, and the recommendations in it are now Administration policy. I mention this only to reassure anyone who might still question whether we are really serious about trade enforcement. I will work with Secretary Baker in fulfilling our pledge to the President.

And to summarize on some of the points I have made, we will pursue our trade enforcement policies without adversely affecting the flow of import shipments into the United States.

The second point I will leave with you is this: despite the initiatives in the commercial area that I have mentioned this afternoon, I am not completely satisfied that we have done everything possible to improve and streamline the commercial side of Customs.

Accordingly, I have taken, and am taking, a number of actions designed to further our progress:

- I have reorganized my office to improve coordination and oversight of Customs commercial functions.

- I have communicated to Commissioner von Raab my position that commercial operations will be a high resource priority. Specifically, I have established a base, or floor, for commercial staffing at the current levels. And I will use my best efforts to uphold our commitment in this area in the overall government budget process.

- I have designated commercial operations as one of the top two priorities of this office for the rest of this year. The other, by the way, is our responding to the current narcotics crisis on the Southwest Border.

- I have established a regulatory review group that will closely monitor Customs regulatory actions in commercial matters. This group will be headed by the Deputy Assistant Secretary for Regulatory, Trade and Tariff Enforcement.

- Finally, I have given my commitment to the continued development of ACS and to the implementation of a user fee package that will ensure a level of Customs commercial staffing to meet workload growth in the coming years.

As a final thought, let me assure you that I am under no illusions regarding the difficulty of the task ahead. As I stated at the outset, it is a question of making difficult choices. In expressing my commitment to the Customs commercial function, I hope I have conveyed to you the overall outlook and perspective with which I intend to make these choices.

In undertaking this effort, I welcome the opportunity to hear your views as representatives of the trade community and the international trade bar.

Finally, let me express my appreciation to the ABA and particularly to David Cohen and David Busby, for the opportunity to share my perspective with each of you today. I also want to thank each of you for your kind attention this afternoon. I look forward to your questions and comments.

TREASURY NEWS

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

<u>For Immediate Release</u>
April 25, 1986

Contact: Charlie Powers
566-8773

TREASURY DEPARTMENT ASSESSES PENALTY AGAINST
CONNECTICUT NATIONAL BANK UNDER BANK SECRECY ACT

The Department of the Treasury announced today that Connecticut National Bank, Hartford, Connecticut, has agreed to a settlement that requires the bank to pay a civil penalty of $220,000 for failure to report in excess of 1,000 currency transactions as required by the Bank Secrecy Act.

Francis A. Keating, II, Assistant Secretary (Enforcement), who announced the penalty, said the penalty represented a complete settlement of Connecticut National Bank's civil liability for these violations. Keating said that Connecticut National Bank came forward voluntarily, cooperated fully with Treasury in developing the scope of its liability, and has instituted measures to ensure full compliance with the Bank Secrecy Act in the future.

The Department of the Treasury has no evidence that Connecticut National Bank engaged in any criminal activities in connection with these reporting violations.

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

FOR IMMEDIATE RELEASE April 28, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,008 million of 13-week bills and for $7,018 million of 26-week bills, both to be issued on May 1, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 31, 1986			:	26-week bills maturing October 30, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	6.04%	6.22%	98.473	:	6.12% a/	6.40%	96.906
High	6.08%	6.26%	98.463	:	6.14%	6.42%	96.896
Average	6.08%	6.26%	98.463	:	6.14%	6.42%	96.896

a/ Excepting 1 tender of $530,000.

Tenders at the high discount rate for the 13-week bills were allotted 91%.
Tenders at the high discount rate for the 26-week bills were allotted 78%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 182,465	$ 132,465	:	$ 63,060	$ 43,060
New York	19,331,570	5,922,790	:	19,325,640	5,924,540
Philadelphia	22,325	22,325	:	12,795	12,795
Cleveland	38,285	38,285	:	17,625	17,625
Richmond	40,115	40,115	:	148,125	37,575
Atlanta	50,290	40,290	:	88,250	66,150
Chicago	1,512,040	150,040	:	1,370,845	136,645
St. Louis	78,905	50,905	:	68,770	40,770
Minneapolis	36,330	33,680	:	41,875	36,375
Kansas City	58,885	58,705	:	42,390	42,390
Dallas	44,820	39,370	:	30,610	24,510
San Francisco	1,836,130	144,270	:	1,537,535	287,715
Treasury	334,845	334,845	:	347,770	347,770
TOTALS	$23,567,005	$7,008,085	:	$23,095,290	$7,017,920
Type					
Competitive	$20,508,200	$3,949,280	:	$19,610,080	$3,532,710
Noncompetitive	1,064,045	1,064,045	:	965,610	965,610
Subtotal, Public	$21,572,245	$5,013,325	:	$20,575,690	$4,498,320
Federal Reserve	1,764,860	1,764,860	:	1,600,000	1,600,000
Foreign Official Institutions	229,900	229,900	:	919,600	919,600
TOTALS	$23,567,005	$7,008,085	:	$23,095,290	$7,017,920

An additional $76,100 thousand of 13-week bills and an additional $290,200 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. April 29, 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 May 8, 1986. This offering will result in a paydown for the Treasury of about $300 million, as the maturing bills are outstanding in the amount of $14,304 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 Daylight Saving time, Monday, May 5, 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 August 8, 1985, and to mature August 7, 1986 (CUSIP No. 912794 KP 8), currently outstanding in the amount of $15,821 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,000 million, to be dated May 8, 1986, and to mature November 6, 1986 (CUSIP No. 912794 LJ 1).

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 May 8, 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 $805 million as agents for foreign and international monetary authorities, and $3,039 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).

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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

For Immediate Release
April 29, 1986

Contact: Bob Levine
(202) 566-2041

U.S.-China Joint Economic Committee Meeting May 8-10

Secretary of the Treasury James A. Baker III will head an inter-agency delegation to the sixth annual session of the U.S.-China Joint Economic Committee in Beijing May 8-10.

Finance Minister Wang Bingqian will head the delegation of the Peoples Republic of China.

Other agencies represented on the U. S. delegation include the Export-Import Bank, the U. S. Trade Representative, the National Security Council, the Department of State and the Board of Governors of the Federal Reserve System.

The meeting will discuss macroeconomic policies of the U. S. and Chinese governments, including prospects for the future, foreign investment, joint ventures and tax policy.

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

TO BE RELEASED AT 4:00 p.m. PRESS CONFERENCE

April 30, 1986

TREASURY ANNOUNCES ELIMINATION OF 20-YEAR BONDS AND CONSIDERATION OF REDUCTION IN SAVINGS BONDS INTEREST RATE FLOOR

20-year bond

The Treasury Department announced today that it will eliminate the regular quarterly 20-year bond cycle. The Department announced on March 18 the cancellation of the 20-year bond that it normally would have auctioned in late March, because Congress had not yet acted to increase the amount of Treasury's authority to issue long-term bonds without regard to the 4-1/4 percent statutory interest rate ceiling. The Department stated at that time that it wished to preserve its then remaining bond authority for the 30-year bond to be offered in the May refunding, because the 30-year bond is a more attractive issue in the market and thus less costly to the Treasury. Over the past month Treasury has carefully assessed the market's reaction to the cancellation of the March 20-year bond and concluded that it would be more cost-effective for the Treasury to issue larger amounts of 10- and 30-year securities rather than 20-year issues. That decision is reflected in the significant increases in the amounts of the 10- and 30-year issues announced today. While there will be no 20-year issues in the near future, the maturities and timing of Treasury issues over the longer run will, of course, depend upon market conditions and total financing needs at the time.

Savings Bond rate

The Treasury also announced that it is considering the need to reduce the guaranteed minimum interest rate on new issues of U.S. Savings Bonds.

The Treasury is pleased with the success of the market-based variable rate savings bond introduced in November 1982. Since then Series EE savings bonds have provided a yield equivalent to 85 percent of the 5-year Treasury marketable rate for savings bonds held at least 5 years. Such bonds, like the previous EE bonds, have early redemption and tax deferral advantages not offered on Treasury marketable securities, and also have a guaranteed minimum rate of 7.5 percent if held at least 5 years. The new savings bond has been well received by savers, while at the same time it has been a cost effective means of financing a portion of the public debt, as compared to financing with marketable securities. Sales of savings bonds have more than doubled, from $779 million in the third quarter of 1982 to $1.7 billion in the first quarter of 1986.

Market yields have declined substantially since the current terms of the market-based savings bond were established. The market-based savings bond rates are calculated in six-month blocks, and are announced early in May and November each year. The first market-based rate announced in November 1982 was 11.09 percent. The rate for the current 6-month period is 8.36 percent, for bonds purchased through today. The rate for the May-October period, to be announced later this week, will be about 7 percent. Thus, the variable market-based rate, for the first time, will be lower than the 5-year floor rate of 7.5 percent.

In these circumstances, Treasury is considering a reduction in the 7.5 percent floor for future issues of Series EE savings bonds, in order to preserve the cost effectiveness of the program and to avoid excessive competition with other savings forms. The Department is not considering a change in the market-based formula, and any reduction in the 7.5 percent guaranteed minimum rate will apply only to bonds sold, or extended in maturity, after the reduction is announced.

TREASURY NEWS

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

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE April 30, 1986

TREASURY MAY QUARTERLY FINANCING

The Treasury will raise about $12,800 million of new cash and refund $14,190 million of securities maturing May 15, 1986, by issuing $9,000 million of 3-year notes, $9,000 million of 10-year notes, and $9,000 million of 30-year bonds. The $14,190 million of maturing securities are those held by the public, including $1,025 million held, as of today, by Federal Reserve Banks as agents for foreign and international monetary authorities.

The 10-year note and 30-year bond being offered today will be eligible for exchange in the STRIPS program and, accordingly, may be divided into their separate Interest and Principal Components and maintained on the book-entry records of the Federal Reserve Banks and Branches. Once a security is in the STRIPS form, the components may be maintained and transferred in multiples of $1,000. Financial institutions should consult their local Federal Reserve Bank or Branch for procedures for requesting securities in STRIPS form.

The three issues totaling $27,000 million are 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 prices of accepted competitive tenders.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $1,819 million of the maturing securities that may be refunded by issuing additional amounts of the new securities at the average prices of accepted competitive tenders.

Details about each of the new securities are given in the attached "highlights" of the offering and in the official offering circulars. The circulars, which include the CUSIP numbers for components of securities with the STRIPS feature, can be obtained by contacting the nearest Federal Reserve Bank or Branch.

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Attachment

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HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
MAY 1986 FINANCING TO BE ISSUED MAY 15, 1986

April 30, 1986

Amount Offered to the Public......	$9,000 million	$9,000 million	$9,000 million
Description of Security:			
Term and type of security.........	3-year notes	10-year notes	30-year bonds
Series and CUSIP designation......	Series R-1989 (CUSIP No. 912827 TP 7)	Series C-1996 (CUSIP No. 912827 TQ 5)	Bonds of 2016 (CUSIP No. 912810 DW 5)
CUSIP Nos. for STRIPS Components..	Not applicable	Listed in Attachment A of offering circular	Listed in Attachment A of offering circular
Maturity date......................	May 15, 1989	May 15, 1996	May 15, 2016
Interest rate......................	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield..................	To be determined at auction	To be determined at auction	To be determined at auction
Premium or discount...............	To be determined after auction	To be determined after auction	To be determined after auction
Interest payment dates............	November 15 and May 15	November 15 and May 15	November 15 and May 15
Minimum denomination available....	$5,000	$1,000	$1,000
Amount Required for STRIPS........	Not applicable	To be determined after auction	To be determined after auction
Terms of Sale:			
Method of sale....................	Yield auction	Yield auction	Yield auction
Competitive tenders...............	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%	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	Accepted in full at the average price up to $1,000,000	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor..............	None	None	None
Payment Terms:			
Payment through Treasury Tax and Loan (TT&L) Note Accounts.....	Acceptable for TT&L Note Option Depositaries	Acceptable for TT&L Note Option Depositaries	Acceptable for TT&L Note Option Depositaries
'ayment by non-institutional .nvestors......................	Full payment to be submitted with tender	Full payment to be submitted with tender	Full payment to be submitted with tender
)eposit guarantee by lesignated institutions...........	Acceptable	Acceptable	Acceptable
:ey Dates:			
:eceipt of tenders...............	Tuesday, May 6, 1986, prior to 1:00 p.m., EDST	Wednesday, May 7, 1986, prior to 1:00 p.m., EDST	Thursday, May 8, 1986, prior to 1:00 p.m., EDST
·ettlement:			
) funds immediately available to the Treasury.....	Thursday, May 15, 1986	Thursday, May 15, 1986	Thursday, May 15, 1986
) readily-collectible check......	Tuesday, May 13, 1986	Tuesday, May 13, 1986	Tuesday, May 13, 1986

TREASURY NEWS

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

STATEMENT OF THE HONORABLE FRANCIS A. KEATING, II
ASSISTANT SECRETARY (ENFORCEMENT)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

MAY 1, 1986

The Treasury View on Legislation to Combat Money Laundering

Mr. Chairman and Members of the Committee:

I sincerely appreciate the opportunity to appear before you to discuss legislative responses to the problems of money laundering, especially legislative initiatives that will enhance Treasury's enforcement of the Bank Secrecy Act. This is my first opportunity to testify before a Senate panel on this subject since I assumed the position of Assistant Secretary last December and to affirm to you my commitment to rigorous and efficient Bank Secrecy Act enforcement.

I especially want to thank Senator D'Amato who early on recognized the magnitude of the money laundering problem and was the earliest proponent of measures to strengthen Treasury's enforcement capability under the Bank Secrecy Act.

Before turning to the legislative measures under discussion, I would like to discuss briefly the importance of the Bank Secrecy Act to law enforcement and recent Treasury initiatives to improve the compliance by financial institutions with the requirements of the Act.

Importance of the Bank Secrecy Act

The enforcement and administration of the Bank Secrecy Act is the centerpiece of Treasury's efforts to combat money laundering. The reporting data generated pursuant to the Act and the regulations under it are essential to our country's investigations into drug trafficking, organized crime, tax evasion and a host of related offenses. The investigations that rely on the information are not Treasury's alone. Other federal agencies and

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state and local law enforcement use this information to uncover and attack the financial base of criminal enterprises.

Some of the most important uses of the information pertain to the thirteen task forces created to investigate organized crime and drug trafficking. Since becoming fully operational in July of 1983, these task forces have initiated over 1200 cases. They have resulted in the indictment of 8500 individuals and 3400 convictions.

These statistics are only part of the story. Two out of every three of those cases have a financial component, and an even larger percentage use Treasury's financial analytical capability in one way or another. This analytical capability, is wholly dependent on the Bank Secrecy Act reporting information. This information, when analyzed, can provide direct leads for new investigations. It can provide support for ongoing investigations. And even where a specific investigation is not involved, the information allows us to track currency flows and detect abnormal patterns that could be an indication of illicit financial activity. This information may reflect the need for international law enforcement cooperation.

Treasury's Compliance Program

Treasury is committed to fulfillment of the statutory mandate of the Bank Secrecy Act of requiring reports and records of information "having a high degree of usefulness to criminal, tax, and regulatory investigations or proceedings." In order to maximize the utility of the required information, universal compliance with the Bank Secrecy Act by all financial institutions is essential. To that end, Treasury has devoted significant effort and resources to compliance enforcement.

For instance, Treasury has imposed a number of civil penalties against financial institutions for past non-compliance. In the wake of the publicity surrounding the Bank of Boston case, and in good measure as a response to Congressional hearings, over sixty banks or bank holding companies have come forward to Treasury with past violations of the Bank Secrecy Act. Some have come forward as a result of bank regulatory examinations, particularly those of the Comptroller of the Currency. To date, sixteen civil penalties have been assessed under 31 U.S.C. § 5321, ranging from $112,000 to $4.75 million in the case of Bank of America.

We believe that Treasury's rigorous enforcement of the Bank Secrecy Act, including the imposition of publicly announced, substantial civil penalties, where appropriate, has contributed to enhanced awareness of the requirements of the Bank Secrecy Act. As a consequence, and as confirmed in our dealings with many banks and the increased volume of Currency Transaction Reports, we believe that overall compliance has improved and that compliance has become a high priority with many major financial institutions.

Improved Examination Procedures

Another major initiative to ensure full compliance with the Bank Secrecy Act has been Treasury's work with bank supervisory agencies to improve and standardize Bank Secrecy Act examination procedures.

As many of the civil penalty cases and the Bank of Boston case demonstrated, the procedures being used by the examiners were not sufficient to ensure that all violations of the Act would be detected, particularly failures to report international bank-to-bank transactions. These procedures needed to be improved, and a number of other issues also had to be considered in order to make compliance examinations more effective. To address these matters, we had a series of meetings with the Federal bank supervisory agencies which resulted in the issuance of uniform procedures for examiners for checking the compliance of financial institutions with the Bank Secrecy Act.

Commitment of Treasury Resources

In July, 1985, the Treasury Department established the Office of Financial Enforcement to assist in implementing and administering the Bank Secrecy Act regulations. The establishment of this office provided a focal point for Bank Secrecy Act related activity within the Treasury Department and acknowledged the increasing importance of the Act in Treasury's law enforcement efforts. The office has broad responsibilities for the compliance activities of all agencies that have been delegated responsibilities under the Act, and there has been an increased commitment of staff resources to the office.

In addition to the increase in the Office of Financial Enforcement, there has been a very large commitment of resources by both the Customs and the IRS. The IRS has established a separate division in Detroit to handle BSA reporting matters. It has taken a number of steps to meet the temporary backlog in processing of Currency Transaction Reports that resulted from the unanticipated surge in reporting following the Bank of Boston case and the permanent increase in filing resulting from the recent heightened awareness of Bank Secrecy Act requirements.

Regulatory Initiatives

Since last year, we have strengthened the Treasury Bank Secrecy Act regulations in several respects. On May 7, 1985, regulations became effective that designated casinos as financial institutions subject to Bank Secrecy Act reporting and recordkeeping requirements. As evidenced in hearings by the President's Commission on Organized Crime last summer, money laundering through casinos may have been even more widespread than once thought. We believe that the new regulations have reduced the attractiveness of the use of casinos for money laundering.

A regulatory amendment pertaining to international transactions was published as a final rule last summer. Under the regulations, Treasury will be able in the future to require a financial institution or a selected group of financial institutions to report specified international transactions, including wire transfers or cashier's checks, for defined periods of time. We envision that this will require reporting of transactions with financial institutions in designated foreign locations that would produce information especially useful in identifying individuals and companies involved in money laundering and tax evasion. The Internal Revenue Service's Office of Criminal Investigations is developing a plan for the initial use of this regulatory authority.

We are also discussing a number of other regulatory amendments, including regulatory solutions to problems of "smurfing" and structuring transactions to avoid the reporting requirements of the Bank Secrecy Act. These revisions are being discussed within Treasury and with the Department of Justice and should be published in the Federal Register within the next few weeks. As with all amendments to the Bank Secrecy regulations, Treasury will consider carefully the financial and operational impact of regulatory changes on financial institutions as it seeks to meet the needs of law enforcement.

Legislation

I would now like to address the various proposals under discussion to bolster our attack against money laundering and to improve Treasury's enforcement of the Bank Secrecy Act.

First is S. 1335, the "Money Laundering and Related Crimes Act," which was developed jointly by the Departments of Justice and Treasury. I would like to remark on the critical revisions to the Bank Secrecy Act contained in the bill. I understand that the Department of Justice will address the provisions of the bill establishing the criminal offense of money laundering and related revisions to Title 18.

Most important, under S. 1335 the Secretary would be given for the first time summons authority both for financial institution witnesses and documents in connection with Bank Secrecy Act violations. This authority was among the legislative recommendations in the October, 1984 report of the President's Commission on Organized Crime on money laundering and is also contained in S. 571 and S. 1385.

Under S. 1335, the Secretary may summon a financial institution officer, or an employee, former officer, former employee or custodian of records, who may have knowledge relating to a violation of a recordkeeping or reporting violation of the Act and require production of relevant documents. This authority is essential both to investigate violations and to assess the appropriate level of civil penalties once a violation is discovered.

This authority is especially needed for enforcement of the Bank Secrecy Act with respect to miscellaneous non-bank financial institutions, such as casinos and foreign currency brokers, which number in excess of 3,000. The responsibility for compliance review of these institutions has been delegated to the Internal Revenue Service. However, currently, the IRS summons authority is restricted to Title 26 purposes. Therefore, in examining these institutions IRS must rely on voluntary cooperation.

Under this bill, a summons would be issued only by the Secretary or with his approval by a supervisory level official of an organization to which the Secretary has delegated Bank Secrecy Act enforcement authority, e.g., the Internal Revenue Service, the Comptroller of the Currency or the Customs Service. An agent or bank examiner in the field could not issue a summons on his or her own authority.

The bill also provides for a civil penalty for negligent violations of the Bank Secrecy Act. Currently, Treasury has authority to assess civil penalties for "willful" violations under 31 U.S.C. § 5321. "Willful" in a civil penalty context means with specific intent or with reckless disregard of the law. Nevertheless, mere negligent non-filing of currency reports deprives the government of potentially useful law enforcement information to the same extent as willful non-filings. The prospect of penalties for negligent violations should encourage financial institutions to give more attention to good compliance.

A provision is added to the civil penalty statute to clarify that criminal penalties under § 5322 and civil penalties under § 5321 are cumulative. This provision makes explicit that if the Secretary of the Treasury assesses a civil penalty in a case and then refers the case to the Department of Justice for criminal prosecution, a court should impose criminal penalties without reference to whether a civil penalty has been imposed. Similarly, if a criminal conviction were to come before assessment of a civil penalty, the Secretary of the Treasury is free to impose the full measure of civil penalties available. I must emphasize that we do not view this provision as new authority, but as a clarification of existing law.

Section 5(b) revises 31 U.S.C. § 5319 relating to disclosure by the Secretary of the Treasury of information reported under the Bank Secrecy Act. Currently, the Secretary is required to make such information available to a Federal agency upon request. The amendment clarifies that the Secretary may also make this information available to a State or local agency and may make disclosure to any Federal agency if he has "reason to believe" the information would be useful to a matter within the receiving agency's jurisdiction, with or without a request. The bill also clarifies that disclosure may also be made to the intelligence community for national security purposes.

Finally, section 5(f) amends the Bank Secrecy Act definition of "monetary instrument" to eliminate any possibility that the current definition could be viewed as a bar to the defining of the term "monetary instrument" by regulation to include, for example, cashier's checks and checks drawn to fictitious payees.

S. 1335 also provides important revisions to the Right to Financial Privacy Act (RFPA). The revisions to the RFPA contained in the Administration's money laundering bill can be considered as an adjunct to that bill, with application separate from the subject of criminal money laundering legislation or enforcement of the Bank Secrecy Act.

The most important and what should be the least controversial of the RFPA revisions is the amendment to subsection 1103(c) of the RFPA, 12 U.S.C. § 3403(c). Currently, § 3403(c) provides that nothing in the Act shall preclude a financial institution from notifying a government authority that the institution has information "which may be relevant to a possible violation of any statute or regulation." The statute gives no guidance on what information can be given without running the risk of exposure to civil liability under the RFPA. The proposed amendment sets out explicitly that enough information can be given to enable Federal law enforcement authorities to proceed with legal process, e.g., summons, subpoena, or search warrant, in accordance with the RFPA. This information at a minimum must include the nature of the suspicious activity, the name of the customer, and other identifying information necessary to identify the customer or the account involved.

We believe you should find very little opposition in the financial community to this particular revision of the RFPA. The revision imposes no new legal duty on financial institutions, clarifies the right of financial institutions to act as good citizens without risk of civil liability, far outweighs any jeopardy to legitimate privacy interests, and would be of major assistance to Federal law enforcement.

For consistent application throughout the United States, this amendment must be accompanied by the proposed preemption provision so that a financial institution that complies with the RFPA will not run afoul of any more restrictive state privacy laws. The proposed clarification of the "good faith defense" to civil liability is also needed to protect financial institutions who cooperate with Federal law enforcement in good faith within the confines of the RFPA.

In addition to the Administration's money laundering bill, there is another legislative initiative fully supported by the Administration on which I urge early and favorable action. This is S. 2306 introduced last week by Senator D'Amato.

This bill would prohibit structuring of currency transactions to avoid the $10,000 currency transaction reporting requirement. Structuring includes the well-known practice of "smurfing." Recent decisions in three Federal Circuits have made it clear that the current law is inadequate to sustain consistent prosecutions for structuring. The proposal would make a person who structures transactions to avoid the currency reporting requirements, or who causes a financial institution not to file a required report, subject to the criminal and civil sanctions of the Bank Secrecy Act.

The bill also provides seizure and forfeiture authority for currency related to a domestic (CTR) reporting violation or interest in property traceable to the currency. The forfeiture would not affect bona fide purchasers who took the currency or property without notice of a reporting violation. Currently, there is forfeiture authority only for monetary instruments underlying violations of the reporting requirements for internationally transported monetary instruments. The forfeiture would not be applicable to domestic financial institutions examined by a federal bank supervisory agency or a financial institution regulated by the Securities and Exchange Commission.

There have been a number of past cases in which the absence of forfeiture authority allowed the proceeds of criminal enterprise to allude the grasp of the government.

Treasury must respectfully take issue with one proposal in S. 1385. This bill would require a financial institution to submit its list of customers exempt from the requirements of the Bank Secrecy Act to Treasury every quarter. Treasury would then have to review and approve or revoke the list within 90 days.

The financial institution would consider the exempt list approved, unless notified otherwise by Treasury within the 90-day period.

Under the current regulations (31 C.F.R. § 103.22(b)), a bank may exempt from reporting certain cash deposits and withdrawals of accounts of retail businesses in amounts commensurate with the lawful, customary conduct of such a business. The bank has a continuing duty to monitor the qualifications for such exemptions. It would be unwise, in our view, to shift the burden of monitoring the eligibility of bank customers for exemptions away from the bank. The bank is in the best position to know its customers, the normal course of their business operations, and changes in their status. Moreover, the provision would take an army of Treasury employees to enforce. The provision is accordingly inefficient, overly burdensome and unnecessary.

We are exploring other solutions to past problems with banks' improper placement of customers on exempt lists. For instance, we are considering a regulation under which a customer would have to attest to information contained in a bank's request for a special exemption. Under S. 2306, a customer who causes a financial institution to put it on the exempt list on the basis of false information provided by the customer would be liable under the Bank Secrecy Act.

We are also planning to work with the banking industry to educate further banks on exemption procedures. We are considering issuing a Treasury publication on the subject that would be available to all financial institutions.

This concludes my prepared remarks. I will be happy to answer any questions the Committee may have.

TREASURY NEWS

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

FOR RELEASE AT 12:00 NOON

May 2, 1986

MAY 6 4 05 PM '86

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $9,250 million of 364-day Treasury bills to be dated May 15, 1986, and to mature May 14, 1987 (CUSIP No. 912794 MK 7). This issue will provide about $700 million of new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $8,550 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 Daylight Saving time, Tuesday, May 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 May 15, 1986. In addition to the maturing 52-week bills, there are $13,788 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 $1,561 million as agents for foreign and international monetary authorities, and $5,408 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 $205 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-565

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 May 5, 1986

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,079 million of 13-week bills and for $7,001 million of 26-week bills, both to be issued on May 8, 1986, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing August 7, 1986			26-week bills maturing November 6, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	6.05%	6.23%	98.471	6.08%	6.36%	96.926
High	6.07%	6.25%	98.466	6.10%	6.38%	96.916
Average	6.07%	6.25%	98.466	6.09%	6.37%	96.921

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 54%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 37,100	$ 37,100	$ 29,045	$ 29,045
New York	26,369,345	6,222,780	20,130,815	5,380,715
Philadelphia	29,425	29,285	16,320	16,320
Cleveland	57,950	55,930	24,615	24,615
Richmond	45,160	45,160	50,000	38,620
Atlanta	37,070	37,070	47,505	33,205
Chicago	1,837,915	83,450	1,431,000	246,310
St. Louis	82,470	54,470	74,550	46,550
Minneapolis	11,260	10,860	11,770	11,770
Kansas City	59,115	59,115	45,960	45,925
Dallas	41,145	31,145	31,690	21,690
San Francisco	1,361,085	71,710	1,550,990	732,010
Treasury	340,670	340,670	374,075	374,075
TOTALS	$30,309,710	$7,078,745	$23,818,335	$7,000,850
Type				
Competitive	$27,497,005	$4,266,040	$20,832,205	$4,014,720
Noncompetitive	1,095,120	1,095,120	859,790	859,790
Subtotal, Public	$28,592,125	$5,361,160	$21,691,995	$4,874,510
Federal Reserve	1,540,925	1,540,925	1,500,000	1,500,000
Foreign Official Institutions	176,660	176,660	626,340	626,340
TOTALS	$30,309,710	$7,078,745	$23,818,335	$7,000,850

An additional $45,240 thousand of 13-week bills and an additional $179,060 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

B-566

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M. May 6, 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 May 15, 1986. This offering will provide about $200 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $13,788 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 Daylight Saving time, Monday, May 12, 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 February 13, 1986, and to mature August 14, 1986 (CUSIP No. 912794 KZ 6), currently outstanding in the amount of $7,046 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,000 million, to be dated May 15, 1986, and to mature November 13, 1986 (CUSIP No. 912794 LK 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 May 15, 1986. In addition to the maturing 13-week and 26-week bills, there are $8,550 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 $1,340 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $1,545 million as agents for foreign and international monetary authorities, and $5,428 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).

B-567

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 May 6, 1986

RESULTS OF AUCTION OF 3-YEAR NOTES

The Department of the Treasury has accepted $ 9,013 million of $ 24,964 million of tenders received from the public for the 3-year notes, Series R-1989, auctioned today. The notes will be issued May 15, 1986, and mature May 15, 1989.

The interest rate on the notes will be 6-7/8%. The range of accepted competitive bids, and the corresponding prices at the 6-7/8% interest rate are as follows:

	Yield	Price
Low	6.94%	99.827
High	6.98%	99.720
Average	6.97%	99.747

Tenders at the high yield were allotted 8%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 45,560	$ 15,560
New York	21,515,165	7,886,005
Philadelphia	16,750	16,750
Cleveland	257,715	49,315
Richmond	45,065	33,385
Atlanta	42,385	40,465
Chicago	1,920,825	656,545
St. Louis	96,095	76,095
Minneapolis	31,095	25,595
Kansas City	91,685	89,685
Dallas	18,450	14,450
San Francisco	881,595	107,395
Treasury	2,085	2,085
Totals	$24,964,470	$9,013,330

The $9,013 million of accepted tenders includes $685 million of noncompetitive tenders and $8,328 million of competitive tenders from the public.

In addition to the $9,013 million of tenders accepted in the auction process, $388 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,019 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 May 7, 1986

RESULTS OF AUCTION OF 10-YEAR NOTES

The Department of the Treasury has accepted $9,017 million of $20,830 million of tenders received from the public for the 10-year notes, Series C-1996, auctioned today. The notes will be issued May 15, 1986, and mature May 15, 1996.

The interest rate on the notes will be 7-3/8%.1/ The range of accepted competitive bids, and the corresponding prices at the 7-3/8% interest rate are as follows:

	Yield	Price
Low	7.45%	99.478
High	7.48%	99.270
Average	7.47%	99.339

Tenders at the high yield were allotted 80%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 44,318	$ 4,318
New York	18,542,363	8,405,363
Philadelphia	605	605
Cleveland	30,676	25,676
Richmond	16,394	9,394
Atlanta	28,057	22,457
Chicago	1,303,456	380,056
St. Louis	70,728	54,728
Minneapolis	20,131	18,131
Kansas City	28,805	26,805
Dallas	5,916	1,916
San Francisco	738,434	67,434
Treasury	324	324
Totals	$20,830,207	$9,017,207

The $9,017 million of accepted tenders includes $432 million of noncompetitive tenders and $8,585 million of competitive tenders from the public.

In addition to the $9,017 million of tenders accepted in the auction process, $5 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $500 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.

TREASURY NEWS

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

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TESTIMONY OF THE HONORABLE
GEORGE D. GOULD
UNDER SECRETARY FOR FINANCE
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to present, in conjunction with Chairman Gray, the Administration-Federal Home Loan Bank Board (FHLBB) proposal to recapitalize FSLIC.

We have developed this plan in alliance with the leadership of the twelve Federal Home Loan Banks (FHLBanks), whose contribution of up to $3 billion of capital is at the core of this effort to strengthen FSLIC. We also have worked closely with the leaders of the thrift industry, to our substantial benefit. In particular, the officials and staffs of the U.S. League of Savings Institutions and the National Council of Savings Institutions have given us thoughtful and constructive counsel. The result, I believe, is a popular proposal that will strengthen FSLIC, free FSLIC to resolve its problem cases more expeditiously, and increase depositor confidence.

Need for This Proposal

This Subcommittee is well informed about the problems of FSLIC and the savings and loan (S&L) industry, so I will not dwell long on the need for this proposal. Nevertheless, a brief statement of need may give you the context within which we developed this plan.

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Estimates of the size of the problem confronting FSLIC vary widely: Most range from about $10 to $25 billion. The crux of the problem is that the assistance costs, even under the most conservative estimates, exceed FSLIC's present financial reserves of about $6 billion.

If we do not recapitalize the fund, FSLIC would need to continue deferring the resolution of many problem S&Ls. This deferral would only increase the fund's ultimate costs. With the appropriate financial and organizational resources, the FHLBB and FSLIC could set more ambitious targets and resolve more cases, more quickly.

This is a propitious time to act. The attractive interest rate environment provides the ideal window of opportunity to move ahead vigorously to deal with ailing S&Ls.

Action now on the thrift industry problem should reaffirm depositor confidence in the health and stability of depository institutions and the viability of the deposit insurance funds. Furthermore, prompt handling of the most debilitated S&Ls should help healthy S&Ls by lowering their cost of deposits, which have been bid up by the feeble S&Ls' call for funds at any price.

If we do not strengthen FSLIC now, we may place the S&L industry at considerable risk in the future should interest rates rise significantly.

Objectives Guiding the Recapitalization Proposal

Six major objectives guide our FSLIC recapitalization proposal.

First, the proposal balances the financing burden between the Federal Home Loan Banks (FHLBanks) and the S&Ls. The cost will be borne entirely by them, without any taxpayer funds.

Second, we transfer funds from these sources to FSLIC through a combination of assessments and stock purchases (most of which will be non-redeemable under all circumstances) to avoid a negative budgetary effect. I will explain more about this stock investment later in this statement.

Third, this plan can supply up to $25-30 billion to FSLIC over approximately the next 5 to 6 years, with approximately $15 billion available in the first 3 years. Given FSLIC's organizational constraints, this infusion probably represents the maximum level of resources that FSLIC can efficiently use to resolve problem cases. Because the plan is flexible by design, FSLIC need not draw this full amount if the size of the problem turns out to be at the low end of the estimated range.

Fourth, the funds transfer to FSLIC is not dependent on any U.S. Government or FSLIC guarantees of debt.

Fifth, the proposal seeks to accommodate the FHLBanks' concerns about a substantial increase in their debt costs and the accounting treatment of their capital contribution. It also recognizes that the allocation of contributions among the FHLBanks needs to take into account their proportions of FDIC-insured members.

Sixth, this plan addresses the S&L industry's overwhelming concern -- the continuation of the FSLIC special assessment -- by creating the substantial likelihood that this extra assessment can be phased out over the next five years. (The special assessment is one eighth of one percent of deposits, in addition to the regular assessment of one twelfth of one percent. If the size of the problem is within the range suggested by a major industry task force -- $8 to $15 billion -- there should be no doubt that the special assessment could and would be phased out.) We believe it is important to show the high probability of eliminating this extra premium over time (even if the problem cost turns out to be $25 to $30 billion), because it is a heavy burden on the industry and we would like to decrease the incentive for healthy thrifts to switch from FSLIC to FDIC insurance.

Description of the Proposal

In essence the recapitalization proposal leverages both the current earned surplus of the FHLBanks and future FSLIC assessments to get equity funds into FSLIC more quickly. A separate corporation (the "Financing Corporation") capitalized by the FHLBanks will undertake a specially designed financing over time to channel equity investments into FSLIC. The proposal contains important safeguards to ensure that both the principal and interest on the Financing Corporation's special borrowings will be repaid.

Most of the Financing Corporation's investment in FSLIC, however, will be in the form of non-redeemable capital certificates that will never be repaid. The remainder of the Financing Corporation's investment in FSLIC will be in the form of non-voting capital stock that may or may not be repaid, with or without a return, depending on FSLIC's financial performance (as measured through FSLIC's reserve-to-deposits ratio).

The key elements of the proposal are as follows:

o The FHLBB charters a "Financing Corporation," capitalized with no more than $3 billion of the FHLBanks' surplus over about 5 to 6 years. (The FHLBanks had $1.8 billion in earned surplus at year-end 1985; they earned over $1 billion in 1985 and added about $290 million to their earned surplus.) The Financing Corporation will not have its own paid staff.

- The Financing Corporation borrows approximately $10 billion through long-term bonds (15 to 30-year maturities) over these five to six years. It assures payment of these bonds' principal, without passing any debt obligation to FSLIC, by buying approximately $2 billion of long-term, zero-coupon instruments, which will equal the bond principal upon maturity. The Corporation will be subject to stringent limits on activities, leverage and life. (The FHLBanks estimate that the Corporation's debt will yield 50-75 basis points, a half to three quarters of a percentage point, above Treasuries of comparable maturity.)

- The Financing Corporation then invests the same amount the FHLBanks invested in it (a maximum of $3 billion) in non-voting capital stock of FSLIC and an additional $8 billion (or more) in non-redeemable capital certificates of FSLIC. (The Financing Corporation could borrow approximately an additional $5 billion, if needed, by increasing its purchase of zero-coupon instruments from $2 billion to the full $3 billion of its available capital.)

- FSLIC employs some of its assessment income to pay dividends to the Financing Corporation, which uses this money to pay interest on its bonds. (When the Financing Corporation's debt is extinguished, the dividends from FSLIC end.)

- FSLIC uses the rest of its assessment income to add to its case resolution resources. The combination of equity and assessments enables FSLIC to deploy about $15 billion in case resolution funds in the first 3 years and about $10 billion more over the next 2 years.

- The special assessment can be phased out gradually over 5 years, while still securing this $25 billion for FSLIC.

- The Financing Corporation would repay its debt principal (through the maturing zeros) around 2020. FSLIC would <u>not</u> by repaying this debt, nor would it be contingently liable for it.

- FSLIC would retire its outstanding stock, held by the Financing Corporation, after the Corporation repays all its debt. (The book value of the FSLIC stock could be as high as $3 billion, if the FHLBanks make their full capital contribution to the Corporation.) The payoff of both the book value and a return on this stock upon retirement would be totally dependent on FSLIC's financial performance (its reserve-to-deposits ratio). After 1996, if FSLIC's reserve-to-deposits ratio reaches certain levels, FSLIC would make contributions to an equity return account. This account, which would be held by FSLIC until the Financing Corporation paid off all its debt, would be the sole source of funds for paying off the FSLIC stock. The non-redeemable capital certificates issued by FSLIC would be extinguished without <u>any</u> repayment.

- The Corporation must sunset by 2026 (or earlier if it has repaid all its debt); its ability to borrow net new funds would end in 1996.

- The attached diagrams illustrate how the proposal would operate.

<u>Flexibility of the Proposal</u>

This proposal incorporates some flexibility in the event the industry problem is larger than estimated and FSLIC needs more funds. Alternatively, the structure could employ less funds from the FHLBanks and the industry if the problem proves less costly.

First, the Financing Corporation could borrow more than $10 billion (by approximately another $5 billion), while continuing to ensure that all the debt principal will be repaid by the maturing zero-coupon instruments it purchases. This expansion could be achieved by employing the Financing Corporation's full $3 billion capital base (as opposed to just $2 billion, as in the basic plan), to buy zero-coupon instruments that will pay off the debt principal.

Second, in the event interest rates rise, the face value of the zero-coupon instruments (the value at maturity) that can be purchased by the Financing Corporation will increase. More face value can be acquired because a zero-coupon instrument in effect pays off all interest, at a compounded rate, together with the amount originally invested, when the instrument matures; so a higher interest rate compounded over time will produce a higher face value amount of a zero-coupon instrument for a given initial investment. This increased amount at maturity would enable the Financing Corporation to use its initial capital to back a larger amount of borrowings. Similarly, the Financing Corporation could generate a larger payoff from the zero-coupon instruments it purchases by selecting ones with longer maturities (more years to compound the interest).

Third, if absolutely necessary, FSLIC could maintain a portion of the special assessment. While FSLIC should preserve this additional assessment authority, its use beyond the 5-year phaseout should be avoided if at all possible.

Budgetary Treatment

This proposal is structured carefully to create fair and appropriate budgetary receipts that will offset FSLIC's case resolution costs; these costs are scored as budgetary outlays.

Assessments always have been counted as budgetary receipts. The equity investment in FSLIC also should be counted as a budget receipt for four primary reasons.

First, FSLIC would never repay, under any circumstances, the bulk of the funds invested in it by the Financing Corporation. These non-redeemable capital certificates will represent between $8 to $12 billion of the funds invested in FSLIC.*/

Second, FSLIC's responsibility to pay off the non-voting capital stock owned by the Financial Corporation is completely dependent on FSLIC's financial condition (its reserve-to-deposits ratio). The size of this stock is exactly equal to the amount of capital the FHLBanks have contributed to the Financing Corporation (a maximum of $3 billion). There is no assurance that the Financing Corporation, and hence the FHLBanks, will get this equity investment back.

Third, like other forms of equity, the possible return on this capital stock investment in FSLIC is dependent on higher levels of FSLIC's financial performance. Even then, the FHLBB must approve this return on investment.

Fourth, while this transaction does involve a borrowing (borrowings are not budget receipts), the Financing Corporation, not FSLIC, does the borrowing. The Financing Corporation, not FSLIC, would be responsible for paying off the principal on this debt. Indeed, the proposed legislation will state that the Financing Corporation's debt is not an obligation of the U.S. Government or FSLIC. The payment of principal on the Financing Corporation's

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*/ There is an analogy between these certificates and the recent one percent deposit that capitalized the National Credit Union Fund, which is counted as a budget receipt. Neither will ever be repaid. Both pay a rate of return. (Indeed, the non-redeemable certificates in this plan will stop paying a return when the Financing Corporation repays its debt.) The dividends that provide the return will be scored as outlays when paid out.

debt is assured by its purchase of the zero-coupon instruments. (FSLIC will pay dividends, which will count as budget outlays when they occur, on the equity invested in it, and these dividend payments will be used by the Financing Corporation to pay the interest on its debt. It is in the nature of equity, which may or may not be paid off, to pay dividends.)

Benefits

To summarize the benefits of this FSLIC recapitalization proposal:

- o FSLIC will be able to employ about $25 billion over 5 years to resolve its case load of problem thrifts. These funds should be transferred to FSLIC about as quickly as we can reasonably expect the FSLIC organization to handle its problem cases effectively.

- o By handling insolvent S&Ls more expeditiously, FSLIC can halt the expansion of the problem.

- o The certain availability of about $25 billion for FSLIC should increase depositor confidence. This confidence, plus the sale, merger, or liquidation of the weakest S&Ls, should help the industry lower its cost of funds.

- o The FSLIC recapitalization burden will be shared fairly between the S&Ls and the FHLBanks. Moreover, the contributions are structured to minimize the adverse effects on both. There is a high probability that the special assessment on the S&L industry can be phased out over 5 years.

- o Regular FHLBank debt should be protected from possibly higher borrower spreads.

- o The legislation requiring the FHLBanks' investment in the Financing Corporation would resolve the FHLBanks' concerns about fulfilling fiduciary duties.

- o The equity nature of the FHLBanks' capital contribution to the Financing Corporation -- which links the repayment of the stock and the possibilities of higher returns to FSLIC's financial performance -- should ease the FHLBanks' accounting treatment. Moreover, it gives the FHLBanks (whose Presidents are the FHLBB's principal supervisory agents for each district) an additional future economic interest in the condition of FSLIC and the industry.

- o The formula that governs the FHLBanks' capital contribution will accommodate FHLBanks with a large percentage of FDIC-insured members.

- Finally, the flexibility built into the proposal permits the FHLBB to raise a range of funds for FSLIC, depending on FSLIC's needs.

H.R. 4701 -- The Financial Institutions Emergency Acquisitions Amendments of 1986

Mr. Chairman, I understood that these hearings also are intended to address H.R. 4701, the Financial Institutions Emergency Acquisitions Amendments of 1986.

The Administration strongly supports H.R. 4701. The emergency acquisition provisions you authored in 1982 have proven most beneficial -- by reducing costs for the insurance funds, helping to maintain financial services to communities, and assisting to secure the stability of the financial system. We believe that H.R. 4701 furthers these ends even more.

My prior statement before this Subcommittee emphasized some of the benefits we believe would be served by a liberalization of the emergency acquisition provisions of the Garn-St Germain Act. The banking regulators are in a better position than I to explain how the particular features of H.R. 4701 are designed to suit their emergency needs. I know that Comptroller of the Currency Clarke will address this subject in detail today, including some minor technical suggestions.

I would, however, be pleased to assist the Subcommittee in any way you consider constructive to secure the enactment of H.R. 4701.

Conclusion

I expect that the Administration will offer you the FSLIC Recapitalization bill language within days. It is in the final stages of our clearance process. After you receive this proposed legislation, I would, of course, be pleased to address any questions in any manner that would be most beneficial to you.

I know we share a deep interest in strengthening FSLIC as promptly as possible. The need is clear, the time is auspicious. The sooner this proposal becomes law, the sooner FSLIC can move its case resolution effort into high gear -- and the sooner depositors will know that their government, the Congress and the Executive branch, can act together to protect the safety and soundness of the financial system.

I would be pleased to try to answer any questions you might have.

Attachments

Illustration of the FSLIC Recapitalization Proposal

1) Impact on the Government

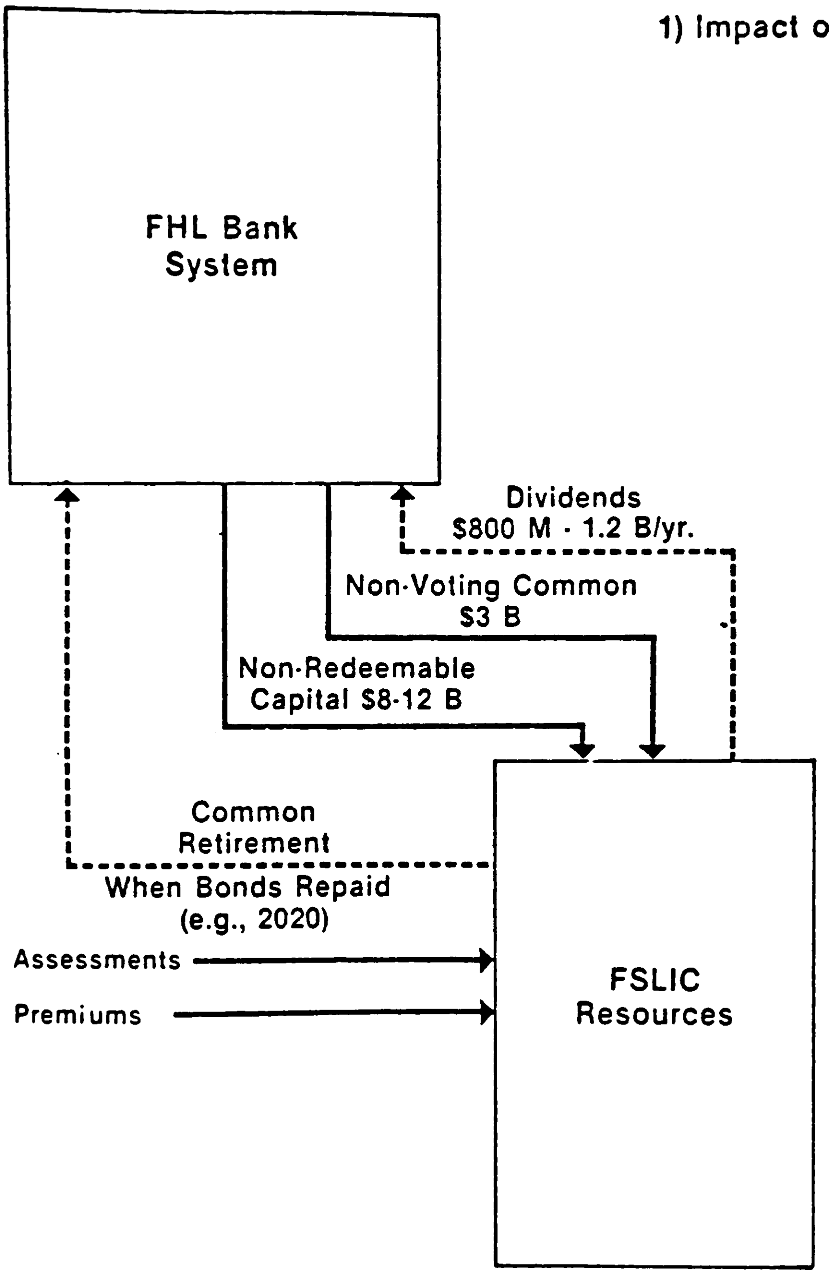
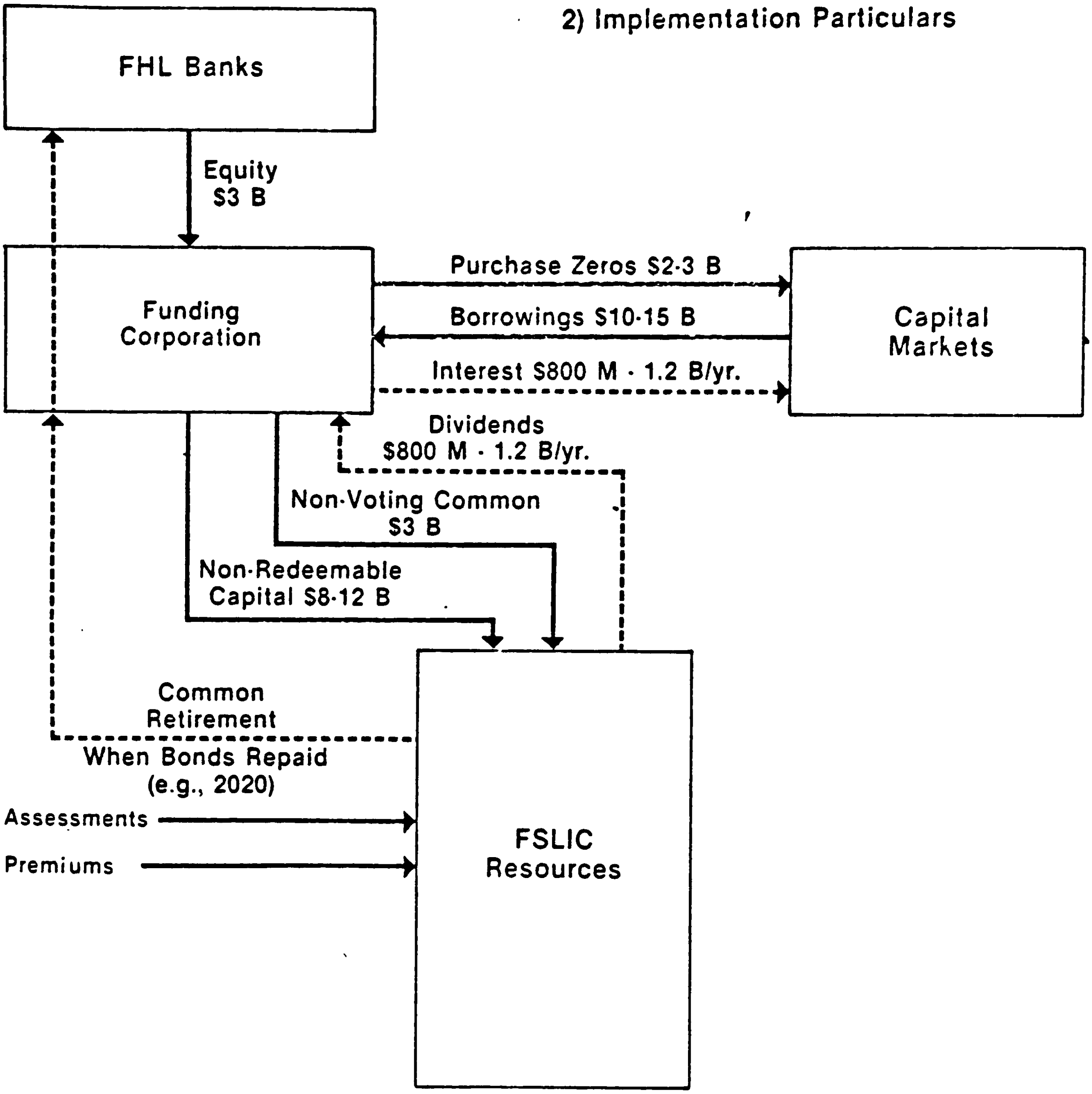


Illustration of the FSLIC Recapitalization Proposal

2) Implementation Particulars



TREASURY NEWS
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TESTIMONY

Robert A. Cornell
Deputy Assistant Secretary
Trade and Investment Policy
Department of the Treasury
before the
Subcommittee on Telecommunications, Consumer
Protection and Finance
of the
Committee on Energy and Commerce

May 8, 1986

I appreciate the opportunity to submit the Department of the Treasury's views on foreign direct investment to the Subcommittee today. In my testimony today I would like to:

-- Present a short summary of U.S. Government policy concerning foreign investment;

-- Review the data collection efforts of the U.S. Government with respect to foreign investment in the United States and their adequacy; and

-- Offer comments on H.R. 2582.

U.S. Investment Policy

Our country is now in the unique position of being the host to more foreign direct investment--approximately $175 billion at the end of 1985--than any other country in the world. We are also now on balance a debtor country. At the same time the United States remains, with over $250 billion in direct investment abroad, the largest home country for corporations with foreign affiliates. Foreign investments in the United States have provided substantial benefits to this country, including increased employment, new managerial and productive techniques, improved efficiency for U.S. industries, strengthened U.S. capital markets and increased productive capacity. Our outward direct investment plays a vital role in the countries in which it locates, is a very significant factor in U.S. trade, and provides our companies with sizable income each year, $35 billion in 1985. We, therefore, clearly have a substantial interest in the conditions under which investment flows occur.

Investment Policy Statement

On September 9, 1983, President Reagan issued an investment policy statement which reflects our recognition of the important role played by international investment in the United States and world economies. It was the culmination of extensive interagency discussions over a period of months.

It spells out the general principles of our free and open policy on international investment, which are as follows:

-- Foreign investment contributes to economic growth and development and promotes worldwide efficiency in production;

-- The maximum contribution from such investment occurs when it flows according to market forces;

-- Foreign investment that flows according to market forces is welcomed in the United States;

-- Foreign investors here generally receive national treatment, which is treatment of the investments of foreign nationals and companies that is no less favorable than that accorded by the United States in like situations to the investments of nationals or companies of the United States;

-- Our companies should receive similar treatment abroad;

-- We oppose the use by governments of distortive measures designed to tilt the benefits of investment and trade in their favor;

-- We intend to pursue an active policy toward international investment designed to reduce government actions that impede or distort investment flows; and

-- We will work to protect U.S. investors abroad.

We are actively implementing this policy by pursuing both multilateral and bilateral initiatives. For example, in the Organization for Economic Cooperation and Development (OECD) we have a work program underway to study the impact of investment incentives and performance requirements. We have encouraged the multilateral development banks to explore ways to strengthen the role of the private sector in facilitating direct investment flows to the developing world. Such flows play a crucial role in our strategy for promoting renewed growth in developing countries with large external debts. We are working very hard to persuade the contracting parties of the GATT to discuss investment issues in the GATT New Round with a view to adopting a multilateral framework that will reduce government interference with investment flows, in particular to discipline the imposition of performance requirements (such as to export or substitute local content for imports) on foreign investors. We are pursuing an active program regarding bilateral investment treaties which calls for signatories to provide foreign investors with a stable and predictable investment climate.

We are negotiating in the OECD with many other countries to get them to reduce and eliminate their remaining limitations on inward investment. The Code of Liberalization of Capital Movements of the OECD has already achieved significant liberalization and aims at further liberalization of investment regimes. It is the intent of the Code that all liberalizing measures be applied to all member countries in a non-discriminatory manner. The related OECD National Treatment instrument calls for national treatment of already established foreign investors. As you may know, the United States has been the leading proponent for expanding these national treatment obligations. For example, we have spearheaded a successful effort to add much of the so-called "right of establishment" to the Code's obligations regarding direct investment. The United States is leading efforts to arrange a standstill and rollback of OECD reciprocity measures on the right of establishment. Adoption of new, restrictive reciprocity measures would seriously undermine these efforts.

Foreign Investment in the United States

The United States has long benefited from foreign investment. In fact, the United States could not have developed the way it did without heavy infusions of capital from abroad. A major advantage we have enjoyed in attracting such investment is our steadfast maintenance of an open investment policy. Despite the large amount of foreign direct investment in the United States, foreigners own a relatively small percentage of total U.S. investment in the United States. Foreign investment in the United States is not concentrated in a few sectors; rather, it is spread among a large number of diverse industries.

Safeguards

The United States has a number of safeguards to protect our security and other national interests. Foreign investors, like domestic investors, must comply with all U.S. laws, such as Justice and Federal Trade Commission antitrust requirements, and Securities and Exchange Commission disclosure requirements. Furthermore, we have a number of restrictions on activities of foreign investors in certain key sectors, such as radio and television broadcasting, coastal and inland shipping, air transportation within the United States, and the production and use of nuclear power. In addition, we have an interagency body, the Committee on Foreign Investment in the United States (CFIUS), to review certain foreign investments in the United States.

CFIUS

In 1975 President Ford established by Executive Order the Committee on Foreign Investment in the United States (CFIUS), which the Treasury Department chairs. The CFIUS has the primary Executive Branch responsibility for monitoring foreign investment in the United States and for implementing U.S. policy towards such investments. Its formal membership includes representatives from the Departments of State, Defense and Commerce, the Office of the United States Trade Representative, and the Council of Economic Advisors. In addition, representatives of other agencies participate regularly in CFIUS discussions.

The CFIUS is a monitoring body with authority to review foreign investment which may have major implications for U.S. national interests. It has not been given authority to approve or disapprove foreign investments in the United States. However, through its review and monitoring activities, the CFIUS does focus Executive Branch attention on particular investments, and may accordingly enable Executive Branch agencies to better implement U.S. laws to protect the national interest. The CFIUS has to a large extent focussed on investment by foreign government-controlled firms.

We have since 1975 requested through the CFIUS that foreign governments contemplating direct investment in the United States consult with us in advance of such an investment. As part of the CFIUS procedure we have also contacted the companies and requested that they keep us informed about their negotiation for such a government-owned or -controlled investment in the United States. Our experience is that the companies provide us with the information we need to assess the implications of the investment for U.S. national interests.

Reciprocity

Let me say a few words about reciprocity, since it is an important element of H.R. 2582--which requires a certification from a foreign investor that the country of the foreign investor (and the foreign country of any person that owns 5 percent of the foreign investor) permits a U.S. resident to make an investment of the same type and size and in the same industry as the proposed investment in the United States.

We share the general concern for fair treatment of U.S. investors abroad. However, we believe a policy of reciprocity would harm U.S. interests and undermine U.S. efforts to achieve fair treatment for our investors. Furthermore, we do not believe that adopting a reciprocity policy would lead countries to drop their impediments to foreign investment.

Threatening to close the U.S. market to investors whose home countries restrict U.S. investment may not cause those countries to relax their restrictions. Indeed, these governments might be pleased to have us prevent their investors from investing in the United States, because they want to keep that investment at home--a mistaken view, but one which many governments nevertheless hold.

It is also important to note that the United States has bilateral and multilateral obligations to accord national treatment to foreign investors. Our bilateral Treaties of Friendship, Commerce and Navigation and our bilateral investment treaties contain such obligations. We also have similar obligations under the OECD.

Existing Data Collection on Foreign Investment

The International Investment and Trade in Services Survey Act of 1976 charged Treasury and the Department of Commerce with major data collection and reporting responsibilities concerning foreign investment. Treasury is charged with two major reporting functions pertaining to international portfolio investment. These functions are the operation of the Treasury International Capital (TIC) Reporting System, an ongoing data collection program to secure current information on international portfolio capital flows, and the performance every five years of benchmark surveys of foreign portfolio investment in U.S. securities. International portfolio investment is defined as investment in which there is less than 10 percent direct or indirect control or ownership of an entity in one country by a person or associated group of persons in another country.

The TIC reports are filed monthly or quarterly by banks, securities dealers and nonbanking firms located in the United States on their outstanding positions and securities transactions with foreigners by country. Among other items, these reports provide current data on foreigners' deposits in the United States, their holdings of money market instruments, and their purchases and sales of U.S. securities, by type. The Treasury is currently completing a comprehensive benchmark survey of foreign portfolio investment in the U.S. long-term, marketable securities as of the end of 1984. This survey not only benchmarks the monthly TIC data, but supplements them with detail on the sectors of the economy into which the portfolio investment is flowing. In these data collection programs, the Treasury does not seek to identify individual foreign investors, but rather obtains information about broad categories of investors such as official institutions (central banks and other foreign government institutions), banking offices and other foreign residents.

The Commerce Department's Bureau of Economic Analysis collects data and requires reports when a foreign person establishes or acquires directly or indirectly a 10 percent or more equity interest in a U.S. business enterprise. Information is included on the foreign parent and the means of financing. Five-year benchmark studies and annual surveys are used to calibrate these direct investment data and provide additional information about the business operations and chain of ownership of the investment.

Treasury and Commerce collect, compile and publish international investment data that are principally used for economic analyses, particularly to construct the U.S. balance of international payments account and for analysis of international investment trends. These data are collected under assurances that they will be treated as confidential by the respective collection authorities and individual respondent data are protected by the International Investment and Trade in Services Survey Act of 1976 against unauthorized disclosure.

Adequacy of Our Data Collection Efforts

We believe that the considerable information already collected and reported on foreign investment in the United States under the comprehensive Treasury and Commerce data systems, as well as information of a specific nature reported to other government agencies, is adequate for U.S. Government policy needs. The volume of information collected, while considerable, takes account of the costs to U.S. residents of providing this information.

In addition to the international investment data gathered under Treasury and Commerce data systems, foreign investors must comply with disclosure requirements of several U.S. Government agencies. Under SEC requirements, all acquisitions by U.S. and foreign investors of the beneficial ownership of more than 5 percent or more of the stock in companies registered under the 1934 Act, which includes most public companies, must be reported to the Commission. Reports include both the identity, residence and citizenship of the purchaser, the source of funding and the purpose of the transaction. In addition, all beneficial owners of more than 5 percent or more of the stock in registered companies must file a detailed annual report. The SEC data are available for public inspection.

Also, in the direct investment sphere, the Agricultural Foreign Disclosure Act of 1978 requires, subject to a de minimus exception, that all foreign investors report acquisitions of agricultural or timber land. The exception is for acquisitions not exceeding ten acres if annual gross receipts do not exceed $1,000). This act also requires reporting by U.S. entities in which a foreigner holds a 5 percent or greater interest. The names of the investors are publicly available at that agency.

H.R. 2582

H.R. 2582 would drastically alter U.S. policy and practice with respect to foreign investment in the United States. The major provisions of the bill would:

-- Require prior, detailed, registration with the Commerce Department by a foreign person making investments in the United States that result in foreign ownership or control, directly or indirectly, of 5 percent or more in a U.S. person or property (including through holdings of stock, securities, and short- or long-term debt obligations); $10,000 or more in a deposit in a bank; or $10,000 or more in U.S. Treasury or U.S. Government securities;

-- Require registration of existing investments;

-- Require reporting of and by foreign persons who directly or indirectly control or own 5 percent or more of the foreign investor (calculated as prescribed);

-- Require re-registration whenever there is a 5 percent transfer of ownership in the foreign investor; and

-- Require certification that the laws of the country of the foreign investor (and of the foreign country of any person that owns the foreign investor 5 percent or more) would:

  - Permit U.S. residents to make an investment of the same type and size and in the same industry as the investment being made in the United States,

  - And not subject U.S. investments to restrictions (broadly defined) other than those imposed in the United States.

-- Provide for approval, by enactment of the Congress, of investments when a foreign person is unable to make the required certification;

-- Impose civil penalties for failure to register or file subsequent reports,

-- Impose criminal penalties (on the foreign person, and any U.S. or foreign agent, officer, director, or employee) for willful failure to register or file subsequent reports,

-- Require monitoring of compliance with the Act,

-- Require maintenance of a list of countries which impose more restrictions on investments by U.S. persons than the United States does on investments by foreign persons,

-- Require annual reports to Congress,

-- Make an inventory of registered investments available for public inspection.

Treasury Views on Major Provisions of the Bill

Treasury strongly opposes this sweeping bill, which would subject many types of foreign investments in the United States, including very small ones, to an extraordinarily burdensome, costly and impractical registration system.

The strict reciprocity standard contained in H.R. 2582 would require a foreign investor's decision to invest in the United States to turn in large part on the laws of his country and possibly other foreign countries. The bill would deny the U.S. economy the benefit of an investment here simply because the same investment could not be made by a U.S. investor in a foreign country. This application of reciprocity would be burdensome to the United States economy if the foreign investor takes his investment to another more favorable market.

As I mentioned earlier, the United States, by imposing a reciprocity standard, would violate our international commitments to accord national treatment and most favored nation on entry under numerous bilateral investment treaties and bilateral treaties of Friendship, Commerce and Navigation.

H.R. 2582 would make it more burdensome and expensive for foreign persons to invest in the United States. Few investors are likely to be willing to submit to a regime of reporting that is itself difficult to comply with, but also carries severely punitive penalties for failure to register properly. The information required may not be known to an investor or the information could be subject to interpretation and rapid change. Investors could not afford to make a mistake. It may in fact be impossible to comply with some of the reporting. For example, the bill could impose a reporting requirement on an unsuspecting foreign individual investor who buys shares in a foreign company. The individual may have no knowledge, or access to information, about that company's holdings. The foreign company may already hold or subsequently acquire the requisite shares for reporting foreign ownership in a U.S. company under the bill. The investor would unknowingly be subject to penalties under U.S. law.

H.R. 2582's registration and disclosure requirements would discard confidentiality for foreign residents who deposit funds in U.S. banks, purchase U.S. Treasury or government securities, or who invest in privately held U.S. companies. Most investors--private individuals and firms as well as government institutions and central banks--expect that their investments will be kept confidential. The effect of disclosure would be to discourage investment and to divert investment to other markets where there is respect for and protection of the privacy of investors.

A public registration requirement, as proposed here, which is not also imposed on U.S. domestic investors, would be discriminatory and is likely to be perceived as onerous and not in the spirit of our international agreements. The requirement could be subject to formal complaints in the OECD on the grounds that it frustrates U.S. obligations to liberalize our markets under the Code of Liberalzation of Capital Movements. Such complaints would undercut U.S. efforts to achieve a more open international financial system. It would be more difficult to press others to remove their barriers to U.S. investments.

The U.S. Government has been in the lead bilaterally and within various international fora (the Organization for Economic Cooperation and Development (OECD), and International Monetary Fund (IMF) for the removal of barriers to international investment, which benefits U.S. investors.

H.R. 2582 would impose reporting requirements on foreign residents that ultimately cannot be enforced by U.S. authorities without the cooperation of foreign governments. Such cooperation would likely be hindered by serious objection to the bill's extraterritorial reach. That reach, in itself, would cause serious international friction.

H.R. 2582 would require a significant and costly regulatory bureaucracy to administer, monitor, and enforce compliance with the Act.

H.R. 2582 imposes "red-tape" that could greatly impair markets. At a minimum the requirements are totally inconsistent with the goal of efficient, smoothly functioning and stable financial markets. They would abrogate traditional American economic policy principles.

The requirement that there be public disclosure of a foreign person's investment in U.S. Treasury securities could have serious adverse effects on the liquidity of the U.S. Treasury securities market and thus on the cost of financing the public debt. Given the rapid pace and large volume of daily trading in the Treasury market the disclosure requirements in the bill would add substantial administrative costs to securities trading and would undoubtedly inhibit trading activity and reduce market liquidity. It is a crucial assumption of the U.S. Treasury securities market that the positions and activities of specific participants are confidential. Trading and investment strategies in the Treasury market, which is the largest, most competitive, and liquid financial market in the world, depend on this confidentiality. Any market participant with access to data concerning the positions of other participants would have a significant competitive advantage.

The provisions of this bill would affect more than just foreign participation in the U.S. Treasury securities market. If the long tradition of confidentiality of the ownership of U.S. Treasury securities were broken, <u>all</u> market participants would question whether their positions and activities would remain private.

H.R. 2582 would disadvantage U.S. financial institutions in their competition with foreign institutions. The bill would impose registration and reporting requirements on deposits of $10,000 or more in any domestic or foreign branch of a U.S. bank. Because foreign banks are not generally subject to comparable requirements, these provisions could result in a signifiant outflow of funds from U.S. financial institutions (particularly those with foreign branches holding extensive foreign-source deposits).

It is Treasury's view that the costs of this bill clearly outweigh any benefits that may be intended. The proposed scheme for registering foreign investments would discourage future investments and cause existing investments to be reconsidered. Moreover, the costs to our economy from the loss of foreign investment would be heavy and severe.

By raising the costs of investments from abroad, the bill would deny the U.S. economy those investments that otherwise would have come to this country based on a foreign investor's evaluations of the risks and rewards involved. We would lose investments that would otherwise have been attracted to finance economic growth and create jobs in our economy, as investments flow to the more efficient, unfettered markets.

Furthermore, a registration system for foreign investments would be an impediment to the free flow of foreign investment to the United States. It would discourage the flow of capital needed to finance the continuing U.S. deficit on the current account of our international balance of payments. The United States currently is a net debtor vis a vis the rest of the world and has a current payments deficit which needs to be financed. One way the deficit can be financed is by liquidation of U.S. investments abroad or through a drawdown of U.S. Government reserves of gold and foreign exchange. However, U.S. assets abroad need not be reduced if the U.S. economy is able to attract sufficient lending and investment from abroad. It would be a mistake to take steps that would impede that flow of capital to the United States or to drive up the interest cost of those flows.

Higher interest rates in the U.S. would increase domestic costs, reduce domestic investment in plant and equipment, reduce output, employment, profits and tax revenues. Small and weaker domestic borrowers would be crowded out of financial markets. U.S. firms would clearly be put at a disadvantage compared to their foreign competition. Higher interest rates would also increase the cost of financing Federal and state and local borrowing.

<u>Conclusion</u>

The bill is contrary to U.S. interests. There is no reason to abandon our current policy of encouraging free markets and an open international economic and financial system. We also benefit from an economy open to foreign entrepreneurs and financial institutions who undertake the risks and accept the rewards of their independent decisions to invest in the United States. We benefit through lower costs, higher production, and increasing jobs.

It is our policy to provide national treatment to those who invest in the United States and to work to achieve national and MFN treatment for U.S. investors in foreign countries. We have made international commitments to pursue national treatment because we recognize that it is in our interest to do so. The policy of national treatment accords to foreign investors the same rights and privileges as are given to U.S. domestic investors. It leaves us free to decide how to regulate our own markets and free to welcome those foreign investments that come to our markets to operate according to our rules.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE May 8, 1986

RESULTS OF AUCTION OF 30-YEAR BONDS

The Department of the Treasury has accepted $9,015 million of $19,095 million of tenders received from the public for the 30-year Bonds auctioned today. The bonds will be issued May 15, 1986, and mature May 15, 2016.

The interest rate on the bonds will be 7-1/4%.1/ The range of accepted competitive bids, and the corresponding prices at the 7-1/4% interest rate are as follows:

	Yield	Price
Low	7.34%	98.915
High	7.40%	98.202
Average	7.37%	98.557

Tenders at the high yield were allotted 21%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 22,187	$ 6,187
New York	17,464,856	8,552,566
Philadelphia	113	113
Cleveland	439	439
Richmond	6,245	3,665
Atlanta	15,761	6,391
Chicago	899,688	243,998
St. Louis	60,106	44,106
Minneapolis	8,402	8,402
Kansas City	9,656	9,656
Dallas	1,355	1,355
San Francisco	606,243	137,843
Treasury	58	58
Totals	$19,095,109	$9,014,779

The $9,015 million of accepted tenders includes $337 million of noncompetitive tenders and $8,678 million of competitive tenders from the public.

In addition to the $9,015 million of tenders accepted in the auction process, $300 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.

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

ADDRESS OF THE HONORABLE FRANCIS A. KEATING, II
ASSISTANT SECRETARY (ENFORCEMENT)
AT THE
ANNUAL MEETING OF THE WINE AND SPIRITS WHOLESALERS
OF AMERICA, INC.
RENO, NEVADA

MAY 6, 1986

Recent Developments in the Regulation of Alcoholic Beverages

I am grateful for the opportunity to be here today, and especially to take part in your annual meeting.

The theme you have selected for this year's program -- "shaping tomorrow today" -- is one that is particularly appropriate, both with respect to your business, that of wine and spirits wholesaling, and to mine, the business of government.

The discussions and seminars in which you are participating this week are about looking ahead to the future, and preparing for that future as we meet the challenges of today.

In government, just as in your industry, we have been looking ahead. We are faced with adapting in a time of fundamental change. From our perspective, that has meant performing our statutory duties with relatively fewer resources. The future will require that we continue to meet the challenge of doing more with less.

As we confront this task, we are also dedicated to achieving President Reagan's overall goals in the regulatory area. To further those goals, we have reduced paperwork, relieved regulatory burdens wherever possible, and removed restrictions that stifle initiative and productivity.

In short, we must do more than reduce the size of government. We must achieve the goals of government while at the same time adhering to free market principles. And we must make sure that the taxpayer is getting his money's worth for his tax dollars.

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All of these goals are incorporated into Treasury's regulatory approach. They have particular relevance to the Treasury regulatory program in which all of you have an interest: the alcoholic beverage regulatory program of the Bureau of Alcohol, Tobacco and Firearms.

With ATF, we have sought to meet the President's goals by consolidating administrative functions and overhead, by eliminating burdensome or inessential requirements, and by automating and streamlining our procedures whenever possible.

Of course, there is one overriding goal that governs everything we do in the alcoholic beverage area. We must regulate the industry in ways that best serve the public interest. This means recognizing that alcohol is a special case -- and that regulation in this area is distinctly different from regulation in other areas.

One reason alcohol is a special case is that alcoholic beverages have always been, and probably always will be, the subject of some controversy, particularly in the political arena. Alcoholic beverages are, of course, the only products that have ever been the subject of two Constitutional Amendments: the Eighteenth, the Great Experiment, and the Twenty-First, which repealed it.

And speaking of controversy, I am reminded of the story of a legislator, who some years ago was asked how he stands on drink. He replied: "If by drink you mean that tool of the devil, that destroyer of families, that fuel of criminality, disease, and death, then sir, I stand strongly opposed; but, if by drink you mean, sir, that gentle substance of social conviviality and good fellowship, the liquid of celebration, success, and life, then I stand strongly in favor of it."

In the relatively short time that I have served as Assistant Secretary, I have seen already that the issues arising in the alcohol regulatory area tend to be ones on which the public, and those in the alcoholic beverage industry, have strong views.

With this in mind, I would like to take this opportunity today to discuss a few of the issues involving Treasury and your industry.

One issue that has come to the fore recently is the jurisdiction over Customs bonded warehouses used exclusively for the storage of alcoholic beverages. Treasury has been directed by the Congress to look into the feasibility of transferring jurisdiction over these warehouses to ATF. I know that this is an issue of interest to many of you, but for the sake of those who may not be familiar with it, I want to briefly discuss the background for this.

At present, under a 1984 agreement between Customs and ATF, ATF verifies for Customs the distilled spirits that are imported in bulk and shipped in bond to a distilled spirits plant. This arrangement has worked out well, and it makes good sense from a resource standpoint. ATF officers must visit distilled spirits plants to fulfill their regulatory and revenue collecting functions, and it promotes overall government efficiency to have these ATF officers also perform functions on behalf of Customs.

Because of the success of this approach, we have expanded it to cover the audits and spot checks that Customs performed at the distilled spirits plants to ensure that taxes and duty were properly paid on imported case goods shipments, as well as bulk shipments.

Here again, the responsibilities of the ATF officers with respect to these plants facilitated a merging of these functions. The question that arises, then, is this: Why not do the same for the Customs bonded warehouses that are not co-located with distilled spirits plants, but that handle alcoholic beverages exclusively? In case you are wondering, there are approximately 230 Customs warehouses in this category. Only 30 Customs warehouses are co-located with distilled spirits plants.

My office recently has considered expanding the concept as I have described. ATF, rather than Customs, could then perform the audits and spot-checks for all 260 distilled-spirits warehouses. In my view, this would promote efficiency, save government resources and be more convenient for your industry as well.

Before final action can be taken, we need to arrange for details such as bonding, duty and tax payment, staffing and reporting procedures.

I want to move on to another issue over which members of your industry have raised concerns: the proposed restrictions on the sale of alcoholic beverages to retailers who do not have a current tax stamp. As some of you may know, Treasury proposed legislation that would have made it illegal to sell to a retailer who failed to produce such a stamp. The need for this legislation was identified by the Grace Commission.

After discussions with Congressional staff, Treasury tax policy experts, ATF and the industry, it is now our view that the purposes of the draft bill could also be achieved through a reporting provision. A wholesaler would be free to conduct a transaction with a retailer who failed to produce evidence of payment, but the wholesaler would be required to report such instances to ATF. Penalties would attach to the failure to report rather than to the fact of the sale.

Our objective, of course, is to see that the tax on retail establishments is being paid. We believe an approach involving reporting as I have described will meet this objective.

An alternative to this plan has been suggested as well, but it poses significant problems. This proposal is that each wholesaler periodically report to ATF all the retail establishments with which it does business. Needless to say, these reports would be very duplicative, because any given retailer will do business with a number of wholesalers. Second, and even more important, the reports themselves would bear no relationship to whether or not the tax has been paid. We, therefore, could not support this proposal as an effective use of resources -- government's or the industry's.

Another area of interest is the matter of consumer information about alcohol beverage products. More specifically, we have published a proposal that distilled spirits be labeled to show alcohol content as a percentage of volume rather than by proof, as is now the case. I see two advantages to this approach. Consumers who do not understand the basis for the designation of proof would have a clearer understanding of the alcohol content. Second, alcohol content would then be stated in the same way it is usually reflected on labels for beer and wine. Third, the change would bring U.S. distilled spirits into harmonization with the general practice for European spirits, and this would eliminate one more inconsistency with our trading partners.

Two points should be made, however. First, distillers would be free to display a statement of proof as additional information on the label. This would lessen any consumer confusion that could result from any label change, as well as alleviate any marketing concerns. Second, if the change is adopted, Treasury and ATF would allow adequate lead time so that the change would not be burdensome to the industry. We are now addressing the alcoholic content issue through the rulemaking process. The comment period on the proposal closes on May 27.

There is another rulemaking in this area that is of interest. That is the ATF proposal on reduced proof distilled spirits. We have received over 700 comments on this issue, and we are committed to addressing them promptly so that a final regulation can be published. The comment period on this proposal will close on June 13.

The final point I want to raise today concerns a topic of paramount importance to us all: the prevention of alcohol abuse. While government has a key role to play in this area, the industry also is in a position of exerting its influence to deter and prevent the abuse of alcoholic beverages.

As you know, this Administration has taken a firm stand against alcohol abuse, just as it has taken a firm stand against drug abuse and drug-related crime. We welcome the efforts of private industry in this important endeavor.

I would like to take this opportunity to acknowledge the efforts of your organization in informing the public and discouraging alcohol abuse. As your initiatives exemplify, industry, as well as government, can do much to promote an awareness of this serious social problem and reduce its occurrence.

In conclusion, I want to add that I look forward to working with your organization as we address the various issues arising in the regulation of alcoholic beverages. Together, there is much that we can accomplish as we prepare for tomorrow's regulatory and business environment.

Thank you for your kind attention.