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U.S. DEPARTMENT OF THE TREASURY

PRESS RELEASES

Fil

April 2, 1989

STATEMENT OF THE GROUP OF SEVEN

The Finance Ministers and Central Bank Governors of Canada, France, the Federal Republic of Germany, Italy, Japan, the United Kingdom and the United States met on April 2 in Washington for an exchange of views on current global economic and financial issues. The Managing Director of the IMF participated in the multilateral surveillance discussions.

The Ministers and Governors reviewed their economic policies and prospects based on the agreed arrangements for economic policy coordination. Growth over the past year exceeded expectations and the pattern has been supportive of global adjustment. Inflation remained generally moderate in 1988 but inflationary pressures have recently appeared in a number of countries. External imbalances have been reduced in those countries with the largest imbalances, although recently the pace of adjustment has slowed. Exchange rates have generally been stable.

The Ministers and Governors agreed that sustained non-inflationary growth is essential to dealing with global economic problems and remains the central objective of the coordination process. The success of these efforts depends on continued progress in controlling inflation and gradually reducing external imbalances. While the Ministers and Governors welcome the reduction in external imbalances achieved last year, they stressed that further progress in this area is required.

Based on this assessment of the current situation, the Ministers and Governors concluded that continued efforts are required. In countries with fiscal and trade deficits, especially the United States and also Canada and Italy, further reductions in budget deficits are needed to complement monetary policies in achieving better domestic and external balance and sustained non-inflationary growth. The major surplus countries should pursue economic and structural policies that will sustain adequate growth of domestic demand without inflation and facilitate external adjustment. All countries must pursue structural reforms which will help to sustain non-inflationary growth. The exchange rate stability over the past year has made a welcomed contribution to, and been supported by, the progress achieved in sustaining the global expansion and reducing external imbalances. The Ministers and Governors agreed that a rise of the dollar which undermined adjustment efforts, or an excessive decline, would be counterproductive and reiterated their commitment to cooperate closely on exchange markets.

Ministers and Governors reiterated the importance they attach to steady progress in the Uruguay Round towards greater trade liberalization. They stressed the danger to the global adjustment process of protectionism and committed themselves to resisting these pressures wherever they arise. A more open international trading system is essential to the sustained health of the global economy.

In reviewing the international debt situation, the Ministers and Governors recognized the progress which had been made in several countries, but noted with concern that serious problems remain. Noting the encouragement in their Berlin communique for further development of the debt strategy, they discussed recent proposals by several countries.

The Ministers and Governors agreed that the key principles of the case-by-case, growth-oriented debt strategy remained valid. However, they believed that for countries undertaking fundamental and convincing economic reforms in cooperation with the IMF and World Bank, the debt strategy should be strengthened by placing greater emphasis on voluntary debt and debt service reduction in agreement with the commercial banks as a complement to new lending. They believe this could make an important contribution to efforts to resolve international debt problems by significantly reducing new financing needs to more manageable levels and reducing the stock of debt over time.

They encouraged the IMF and World Bank to continue in their respective roles to work with debtor countries on economic reform programs essential for lasting progress and to place greater emphasis on measures to attract new investment -- noting the role of MIGA in this connection -- and to foster repatriation of flight capital.

They also encouraged the IMF and World Bank to take, in accordance with their established principles, appropriate steps to support efforts to reduce the debt burdens of countries which are committed to substantial economic reforms. This support should be accomplished by setting aside a portion of policy-based loans to facilitate debt reduction transactions. In addition, the two institutions should examine the establishment of limited interest support for transactions involving significant debt or debt service reduction. The concrete negotiations on debt and debt service reduction are a matter for the debtor countries and the commercial banks.

The Ministers and Governors affirmed the key role of commercial banks in resolving debt problems. They further concurred that diversified financial support from the banks is needed to support sound economic reform programs through a broad array of new lending and debt/debt service reduction mechanisms. In order to encourage a broader range of voluntary debt and debt service reduction transactions, the Ministers and Governors encouraged the commercial banking community to consider negotiating waivers of restrictive clauses in existing commercial bank lending agreements for a given period. They also agreed to review, consistent with maintaining the safety and soundness of the financial system, regulatory, tax, and accounting practices with a view to eliminating unnecessary obstacles to debt and/or debt service reduction transactions.

The Ministers and Governors also encouraged the IMF to continue to collaborate actively with the Paris Club.

The Ministers and Governors emphasized the importance of a growing global economy. They concluded by calling on all parties to work cooperatively and promptly to put into place the elements discussed to strengthen the international debt strategy.

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DEPARTMENT

Remarks by

Secretary of the Treasury

Nicholas F. Brady

at the Morning Session of

the Interim Committee

of the International Monetary Fund

Washington, D.C.

April 3, 1989

The World Economic Outlook and the Question of an SDR Allocation

It's a pleasure for me to welcome you to Washington and to take part in the deliberations of this group. We have important issues to discuss today, and I believe that we have the opportunity to make substantial progress on several of them.

Regarding global economic activity, we find ourselves in a better situation than most of us expected a year ago. Industrial country growth strengthened to over 4 percent in 1988, ushering in the seventh consecutive year of expansion. This boosted world trade growth to its best rate of the decade, and helped the developing countries achieve real growth of nearly 4.5 percent.

Moreover, according to the Fund's assessment, the pattern of growth among the industrial countries was generally favorable last year. Aggregate domestic demand growth in our major trading partners strengthened to a level well in excess of that in the United States. This was certainly a welcome development, providing direct support for the global adjustment process and for the aspirations of the developing economies.

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Adjustment of U.S. imbalances continued as we recorded a $34 billion decline in our merchandise trade deficit. Our current account deficit declined less sharply, but still substantially. Japan's large trade and current account surpluses are also being reduced. Importantly, last year we also saw a reduction of the external imbalances of the Asian Newly Industrializing Economies. These trends are essential components of a balanced, world-wide adjustment process. So too would be a substantial decline in the large imbalances within Europe. But on this score, the basic trend in Europe evident last year gives us some concern.

Recently, there have been some concerns about a resurgence of inflation. Clearly, we don't want to squander the hard-won gains we've made against inflation. Some of us -- and here I include the United States -- need to be particularly vigilant on this score. But I do not believe that the data suggest that a serious acceleration of inflation in our countries is underway. We should, therefore, maintain balance in promoting sustained non-inflationary growth while reducing external imbalances.

One of the key tasks for the U.S. is to reduce our Federal budget deficit. There has been progress, but much more clearly remains to be done. I can personally assure you that President Bush is committed to further deficit reductions, and is giving this issue the highest priority. We are actively working with Congress to develop a framework for further progress on this front.

With the achievement of strong fiscal positions in major surplus countries, they now have a greater measure of flexibility to pursue appropriate growth and adjustment strategies. This flexibility can and should be used to help our countries make further progress in reducing external imbalances.

The industrial countries are, of course, well aware of the implications of our performance and policy choices for the rest of the world. Ensuring open and growing domestic markets is a necessary condition for continued developing country growth, and for progress in resolving debt problems. I will have more to say on this latter point during today's afternoon session.

To summarize my views on the world economic outlook, the performance of the global economy in 1988 illustrates that the rewards of sound, coordinated, policies are broadly shared. If each of us keeps sight of our collective objective of balanced and sustained growth, we have every reason to expect continued progress in the years ahead.

The Question of an SDR Allocation

Regarding an SDR allocation, we continue to have reservations as to whether the requirements specified in the Articles of Agreement have been met. The question of an SDR allocation,

however, merits our continued close consideration. In particular, we should study carefully the costs and benefits of various proposals to allocate SDR.

Thank you very much.

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Remarks by
Secretary of the Treasury
Nicholas F. Brady
at the Afternoon Session
of the Interim Committee
of the International Monetary Fund
Washington, D.C.

The International Debt Strategy

The international debt strategy has been of particular concern to this Committee for a number of years. The Interim Committee has in fact provided guidance on this issue not only to the IMF Executive Board, but to the international community at large. It is time once again for this Committee to take a leadership position on the debt problem and provide direction to international efforts to strengthen the debt strategy.

We recently have offered a number of specific suggestions for strengthening the strategy, building on ideas and suggestions put forward by many of you. I am greatly encouraged by the broad international support that has been expressed for the concepts and approach which have been put forward. At the same time, I recognize that many questions remain. It is time, in my view, that we work together to turn these concepts into specifics which provide a basis for lasting progress in dealing with the debt problem.

We believe that the principles of the current strategy -- the vital importance of stronger growth, debtor reforms, external financial support, and a case-by-case approach to individual nations' problems -- remain valid. It also is crucial for the Fund and World Bank to continue to play central roles in the strategy, by assisting developing countries in formulating sound macroeconomic and structural policies, and by helping to catalyze financial support from other creditors.

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Policy reforms to produce key macroeconomic and structural changes are essential to the resolution of debt problems. In addition, special efforts are needed as part of Fund and Bank programs to promote confidence in economic programs and encourage new direct investment flows and the repatriation of flight capital, as alternatives to new debt. The Fund should also develop improved techniques for monitoring flight capital to prompt corrective action at an early stage. Both public and private sources have estimated that assets held abroad by nationals of a number of countries might equal or exceed their external commercial bank debt. These funds, therefore, represent an important potential source of private capital for debtor countries which must be part of any overall approach to the debt problem.

We look to the banking community to support actively debtors' continuing reform efforts through voluntary debt and debt service reduction as well as continued new lending. To facilitate this process, legal constraints in existing bank loan agreements need to be relaxed. In particular, the negotiation of a general waiver of sharing or negative pledge clauses for each performing debtor would be important. This could permit negotiations on a broad range of voluntary debt or debt service reduction transactions between debtors and banks which choose to pursue these alternatives. Such waivers might have a life of perhaps three years, to stimulate debt or debt service reduction within a relatively short timeframe. We expect these waivers to accelerate the pace of voluntary market transactions which reduce debt or debt service, thus benefitting debtor nations and reducing new financing needs to more manageable levels.

But for this process to move ahead, the IMF and the World Bank must also play an active role. We have, therefore, proposed that the Fund and the Bank adapt their policy-based lending programs to support specifically voluntary debt reduction. For debtor nations requesting a debt reduction program, a portion of policy-based loans should be set-aside to support transactions involving significant debt reduction. These funds could be made available to collateralize discounted debt-for-bond exchanges, or to replenish foreign exchange reserves following a cash buy-back, once such transactions have been negotiated with commercial banks.

In addition, we believe that both institutions should make available limited interest support for transactions involving significant debt or debt service reduction. Such support, which could be structured so as to safeguard the financial positions of the Fund and the Bank, could be made available on a rolling basis for a limited period of time. These efforts should help catalyze market activity which could ease debt service burdens, improve debtors' creditworthiness, and provide an impetus to growth. These actions should, therefore, be beneficial to both debtors and creditors alike.

It will be important during the period ahead to maintain a close association between debtor country performance, IMF and World Bank financing, and commercial bank activity. At the same time, we should recognize that rigidities in the current system and lack of early financial support in some cases have made it more difficult for debtor nations to perform well under reform programs. When a country is launching a major economic reform effort, it needs to have visible, meaningful support from the international community from the outset, not months later. We believe, therefore, that the Fund's policies on financial assurances should be reviewed with a view toward greater flexibility in this area. We have suggested that initial disbursements from the Fund and World Bank should occur once a waiver agreement has been reached, but prior to completion of full commercial bank financing packages.

Creditor governments, for their part, should continue to reschedule official debts in the Paris Club and maintain export credit cover for debtor nations adopting Fund and World Bank programs. Countries should also review their respective regulatory, accounting, and tax regimes with a view to reducing impediments to debt and debt service reduction. These are issues for the national authorities to act upon individually, rather than the international institutions. Where possible, creditor governments should provide bilateral funding in support of the strengthened debt strategy. In this connection, we welcome the additional financial support which has been pledged by Japan to support these efforts.

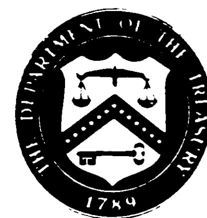
In order to move ahead to strengthen the debt strategy, it is vital that the Interim and Development Committees give clear direction to the IMF and World Bank Executive Boards on these matters. I would then urge both Boards to consider promptly needed changes in Fund and Bank policies in order that new mechanisms could be put in place.

Similarly, I would urge the banking community to begin now to incorporate these ideas in their negotiations with individual countries, in order to reduce the period of uncertainty. Action on waivers is particularly important to creating the scope for voluntary debt or debt service reduction. The balance among debt reduction, debt service reduction, and new lending will, of course, vary from country to country and from bank to bank.

I am confident that this approach to strengthening the debt strategy can provide the basis for renewed progress on the debt problem.

Thank you.

TREASURY NEWS



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April 3, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

APR 4 8 55 AM '89

Tenders for $7,204 million of 13-week bills and for $7,213 million of 26-week bills, both to be issued on April 6, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 6, 1989			:	26-week bills maturing October 5, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.80%	9.12%	97.776	:	8.81%	9.35%	95.546
High	8.89%	9.22%	97.753	:	8.85%	9.39%	95.526
Average	8.87%	9.20%	97.758	:	8.84%	9.38%	95.531

Tenders at the high discount rate for the 13-week bills were allotted 32%.
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	$ 45,720	$ 45,720	:	$ 32,395	$ 32,395
New York	19,487,130	5,523,850	:	21,604,780	5,969,880
Philadelphia	30,690	30,690	:	25,525	25,525
Cleveland	52,850	52,850	:	44,200	44,200
Richmond	69,405	54,405	:	49,915	49,915
Atlanta	46,155	46,155	:	42,075	42,075
Chicago	1,582,450	521,650	:	1,827,915	161,915
St. Louis	57,355	48,955	:	43,455	34,955
Minneapolis	11,840	11,840	:	11,710	11,700
Kansas City	75,265	75,265	:	66,000	66,000
Dallas	28,900	28,900	:	32,770	32,770
San Francisco	1,312,875	260,875	:	1,303,320	158,320
Treasury	502,900	502,900	:	583,480	583,480
TOTALS	$23,303,535	$7,204,055	:	$25,667,540	$7,213,130
Type					
Competitive	$19,521,850	$3,422,370	:	$20,381,115	$1,926,705
Noncompetitive	1,448,840	1,448,840	:	1,346,435	1,346,435
Subtotal, Public	$20,970,690	$4,871,210	:	$21,727,550	$3,273,140
Federal Reserve	2,297,335	2,297,335	:	2,200,000	2,200,000
Foreign Official Institutions	35,510	35,510	:	1,739,990	1,739,990
TOTALS	$23,303,535	$7,204,055	:	$25,667,540	$7,213,130

An additional $4,590 thousand of 13-week bills and an additional $526,110 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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Remarks by
Secretary of the Treasury
Nicholas F. Brady
at the Morning Session
of the Development Committee
of the International Monetary Fund
and the World Bank
Washington, D.C.

I am pleased to participate once again in the Development Committee, which plays an important role in providing guidance on growth and structural reform issues, and on the World Bank's role in the international debt strategy. I would like to touch on these key issues this morning, while concentrating on further steps to strengthen the debt strategy, particularly within the World Bank.

As the Ministers and Governors are aware, we believe that considerable progress has been made in addressing debt problems during the past several years. The principles which have guided us in the past -- the importance of stronger growth, debtor reforms, external financial support, and a case-by-case approach to individual debtors' problems -- remain valid. However, it is clear that new directions for our strategy are now needed.

These should include:

- On the part of debtor nations, a new emphasis on measures to encourage investment and the return of flight capital;
- On the part of commercial banks, stronger emphasis on debt and debt service reduction to complement new lending; and
- On the part of the key international financial institutions, a change in their policies to provide greater encouragement to debt and debt service reduction along with other non-debt private financial flows.

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We have proposed that the World Bank, along with the Fund, set aside a portion of policy-based loans to support transactions involving significant debt reduction which have been negotiated with commercial banks. Such set-aside funds could be used to collateralize discounted debt-for-bond exchanges, or to replenish foreign exchange reserves following a cash buyback.

In addition, we believe that both institutions should make available limited interest support for transactions involving significant debt or debt service reduction. Such support could be structured to safeguard the financial position of the Bank and could be made available on a rolling basis for a limited period of time. We recognize that the interest support proposal involves a number of technical issues for the Bank which require careful consideration. However, we believe it is essential to establish both support mechanisms in order to provide adequate impetus to market activity beneficial to both debtors and creditors alike.

The balance of new lending, debt and debt service reduction will vary from country to country, and will need to be worked out in negotiations between debtor nations and commercial banks. A waiver of the legal constraints in existing commercial bank loan agreements would also be important.

To complement these changes in the Bank's financial policies, there is a need to strengthen the effectiveness of its structural adjustment lending programs. In particular, we believe the Bank should adopt procedures which assure closer monitoring of performance under these loans, including Board approval for release of individual tranche disbursements.

In addition, the Bank should place increased emphasis in its structural adjustment and sector loans on measures to promote foreign direct investment. We are encouraged that MIGA will be moving ahead with its first guarantees in the next few months. The IFC also has a continuing role to play in attracting foreign investment. Moreover, debtor governments should implement sound debt/equity swap programs -- including, where feasible, opportunities for participation by their own citizens as a stimulus to the return of flight capital.

Finally, I would note that environmental reform deserves stronger attention. I would encourage the Bank to establish its own internal environmental impact assessment procedures, and to develop procedures for providing information about environmental aspects of individual loans to non-governmental organizations and community groups. These organizations can provide useful input to the Bank's appraisal of specific projects. I also strongly support the position of my Canadian colleague, Finance Minister Wilson, on increasing public access to environmental information and ask that we have a full and detailed report on where we stand on all of these issues at our September meeting.

Before concluding, I want to refer to another important development in the debt strategy. This is the recent agreement to increase the resources of the Inter-American Development Bank through a major capital replenishment. The IDB can play a role in supporting policy reform in Latin America and the Caribbean through additional financial support for both project and policy-based lending. We welcome the fact that the IDB can now move ahead in this area.

In concluding, I would like to underscore the importance of prompt action by the Bank as well as the Fund in putting into place the mechanisms that can lay the basis for further progress in the debt strategy.

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HIGHLIGHTS OF SPEECH BY
DEPUTY SECRETARY OF THE TREASURY
M. PETER MCPHERSON
BEFORE THE
COUNCIL OF INSTITUTIONAL INVESTORS
WASHINGTON, D.C.
APRIL 4, 1989

Deputy Secretary of the Treasury Peter McPherson today told the Council of Institutional Investors "the Administration believes that U.S. management should have a balanced decision making horizon - short and long term - in order to preserve and advance our competitive position in the world. Accordingly within the context of the current ERISA law, the Administration seeks to encourage a balanced time horizon investment approach by pension funds. Pension plans, as large and growing shareholders with long term liabilities, are in an ideal position to help assure that American management takes a balanced time horizon approach to running their companies."

Mr. McPherson and David Walker, Assistant Secretary of Department of Labor recently held a press conference to underline that pension funds are not required to automatically tender when a tender offer exceeds the market price; rather the pension fund is obligated to go through a process of considering the options and then to act in the best economic interest of the participants and beneficiaries. They were making the point that there is no ERISA obligation to take a short term view.

McPherson said "that a balanced investment strategy is clearly consistent with the pension plans' responsibility under ERISA, subject of course to the pension management's ERISA responsibilities to think through the investment strategy options."

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"This process of thinking through the investment options would often include a review of the long term plans of the corporations in which the pension plans are investing or considering investing. If a pension plan determines that generally a balanced time horizon view of corporate performance is likely to maximize the return for the participants and the beneficiaries, then the pension plan manager should undertake such a strategy."

"Corporate management often complains that it cannot influence their own pension funds. It is true that management cannot influence its pension funds for the benefit of the corporation."

"However, the board of a corporation, a committee of the board or an officer of the corporation, among others, can be the 'named fiduciary' of the corporation's pension plan, and such 'named fiduciaries' have the responsibility of managing the pension fund."

"In brief, many 'named fiduciaries' are committees of the board, 'named fiduciaries' are responsible for determining an investment approach, many 'named fiduciaries' settle upon a balance time horizon approach, and finally those decisions appear generally appropriate under ERISA."

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REMARKS BY
DEPUTY SECRETARY OF THE TREASURY
M. PETER MCPHERSON
BEFORE THE
COUNCIL OF INSTITUTIONAL INVESTORS
WASHINGTON, D.C.
APRIL 4, 1989

RELATIONSHIPS BETWEEN PENSION FUNDS AND CORPORATE MANAGEMENT

The Administration has been giving a great deal of thought to how to support and encourage U.S. managers to take a long term view in their management decisions. To that end and to encourage economic growth, we support capital gains going back into the tax code. We also are supporting legislation to make the R and D tax credit permanent.

This matter of decision making horizons is getting attention because CEOs generally, in fact, feel they are often pressured to take a short term view. This was pointed out in a study prepared by Yankelovich, Cloney, Shulman, summarized in an article in Business Month entitled "Their Deepest Concerns", January, 1988. Moreover, there are specific reasons for concern. For example, some feel that Americans are better today at inventing technology than we are at the time consuming effort of commercializing inventions. The frequently cited example, is the Japanese progress in commercialization of high definial TV even though the most basic technology was invented here.

I should note that not everyone agrees managers are pushed to take a short term view. Some feel that stock markets do not punish, in fact, may even reward the long term view. For example, a study recently undertaken at the Pennsylvania State University suggested that announcements of new expenditures on research and development have frequently increased stock market values. "Fortune" magazine in recent months had a cover story arguing that managers are rewarded in the market by taking the long view in making decisions.

Still, there probably are examples of soundly managed companies with prudent long and short term business strategies in place but with a low stock price because the companies have lost their market luster or fashion. Such companies are ready targets for takeover, despite the best efforts of management.

No doubt many companies do take a long term view when they make decisions. But there is a wide-spread perception that it is difficult for many U.S. companies to take that approach. Part of the reason for this, in the opinion of many, is that there is not a stable relationship between pension funds and corporate management. It is argued that pension funds are not investors but traders and that corporations tend to treat pension funds as such. The focus of this speech is on this relationship between pensions fund and management.

Role of Pension Funds

There has been a great deal of discussion about the role of pension plans in the increased volume of trading on the stock exchanges. Let me present a few facts about the role of pension plans in the markets and the changes in that role over the years. (In this speech "pension plans" or "pension funds" mean both public and ERISA covered private pension funds unless otherwise indicated.)

Pension plan assets have grown much more rapidly than financial assets for the economy as a whole over the past four decades. In 1950 pension plans held only 3% of the total financial assets in the economy. By 1970 they held 9% of all financial assets and by 1987 the pension plan share of total financial assets in the economy had risen to 18%. Pension plans, held less than $100 billion in assets in 1950, but have assets of slightly over $2.0 trillion. Three quarters of these assets are held by private pension plans and the other quarter by public pension plans. This three-quarter to one-quarter split has been stable since 1950.

As pension assets have been increasing dramatically, pension plans have also been shifting a greater proportion of their investments into publicly traded corporate equities. Between 1950 and 1987 the share of pension assets invested in these stocks increased from 8% to 35%. In 1987 private pension plans held 18 percent of all public traded corporated equities, and public pension plans owned 6 for a total of 24 percent. Institutional investors owned about one half of the market, with pension funds being the largest component.

Another important fact is that individual investors, who held as much as 90 percent of publicly traded corporate equities in 1950, now apparently hold a little less than 60 percent.

Institutional investors turnover rates are much higher than individual investors. For example, recent data from the Securities Industry Association (SIA) show that individual investors accounted for about 18% of big board trading in 1988, even though they own nearly 60% and; about 55% of trading was accounted for by institutional investors who own about 50% of the market. About 26% of the trading was formally by security firms

trading for their own account. There is some suggestion that a large part of the security firms' trading may be on behalf of institutional investors so that institutional turnover probably was much higher than 55%.

Historically pension plans (at least private ones for which Department of Labor has data) have had a higher turnover rate than investors in the market as a whole. For example, in 1977, when the annual turnover rate for the New York Stock Exchange as a whole was 21%, the private pension turnover rate was 28%. In 1981 when the market turnover rate was 33%, pension plans had a 52% turnover rate. Thus, between 1977 and 1981 at least, it seems clear that private pension plans were generally out ahead of the market in turnover rates. Between 1981 and 1986 the turnover rate on the New York Stock Exchange increased rapidly, jumping from 33% in 1981 to 64% in 1986. Pension turnover at the end of that period was about 60%. I suggested above that institutional trading on the big board probably was a very large percentage of the total. Also pension trading was almost certainly higher than their ownership percentage, but it may be that the turnover rate of the pension funds was lower than for some other institutional investors. Further figures and studies are needed.

In brief, pension funds have grown rapidly as a percentage of ownership of the total market and they are much more active traders than individuals.

I should also note that institutional investors, including pension funds, own a large percentage of many companies; 30%, 60%, 70% of companies.

My figures come in large part from the Department of Labor who has watched pensions closely. These figures can be debated and are subject to various interpretations.

It should be pointed out that many pension funds are not, in general, active traders and there may be a trend away from active trading. Many pension funds are getting so large that it is not easy to sell because they have to put the proceeds somewhere else. Some argue that the continued growth of the pension funds means that they are likely to become more stable investors in the years ahead. Other factors which encourage a less active trading approach are studies, including a study of the Department of Labor, which suggests that pension funds with active trading approaches frequently don't do better and may not do as well as the overall market. Moreover, the cost of active trading can be substantial. This cost is brokerage fees and the additional fees for active management as opposed to less expensive passive management of funds. Very important also is the market impact cost of trading that may be as much as 100 basis points or more. For all of these reasons, there has been a growing amount of

passive investing by pension funds.

The increased equity ownership by institutional investors, including pension funds, may be the most important development in corporate management/ownership for decades. The last development of such significance was when professional managers began in large numbers to take over control from owner managers, detailed first in 1932 in the Modern Corporation and Private Property by Adolf Berle and Gardiner Means.

However, as stated above this recent shift in ownership, in the opinion of many has not yet settled into a stable relationship between pension funds and corporate management. And some feel that a lack of stability in the relationship between pension funds and corporate managers makes it more difficult for managers to take a long term view in their decision making. To quote a CEO who recently told me, "I don't know if pension investors will stick with me long enough to see through the changes we need in our company."

A Balanced View Under ERISA

Before discussing in detail the problems of the relationship between pensions and management, let me say again the Administration believes strongly that U.S. management should have a balanced decision making horizon - short and long term - in order to preserve and advance our competitive position in the world.

ERISA is designed to give trustees and managers maximum flexibility within the constraints of their fiduciary obligations. The current structure appears to be generally working well. Any changes to the fiduciary standards of ERISA would have to be carefully considered and undertaken with great care. The fiduciary obligations, in particular the prudence standard and the requirement that fiduciaries act solely in the interest of the plan, are central to the law. Modifications would affect many areas governed by the statute, not just the issue of a long term versus short term investment horizon. Accordingly, I am uneasy about the idea of changing the statute.

Nevertheless, within the context of the current ERISA law, the Administration seeks to encourage a balanced time horizon investment approach by pension funds. For example, recently the Department of Labor and Treasury held a press conference to underline that pension funds are not required to automatically tender when a tender offer exceeds the market price; rather the pension fund is obligated to go through a process of considering the options and then to act in the best economic interest of the participants and beneficiaries. Among other things, we were making the point that there is surely no ERISA obligation to take

a short term view. Corporate lawyers have, I am told, tended to advise their clients to take a short term view, e.g. sell when the tender offer is above market, because some of them think that it is the more conservative approach. I refer again to the announcement in our press conference and urge lawyers to be sure that clients truly understand their obligations and options in this area.

To further develop this thought, let me say that pension plans, as large and growing shareholders with long term liabilities, are in an ideal position to help assure that American management takes a balanced time horizon approach to running their companies. That investment strategy is clearly consistent with the pension plans' responsibility under ERISA, subject of course to the pension management's ERISA responsibilities to think through the investment strategy options. This process of thinking through the investment options would often include a review of the long term plans of the corporations in which the pension plans are investing or considering investing. Management no doubt will find it in their interest to articulate such long term plans for pension plan investors and other shareholders. If a pension plan determines that generally a balanced time horizon view of corporate performance is likely to maximize the return for the participants and the beneficiaries, then the pension plan manager should undertake such a strategy.

Corporate management often complains that it cannot influence their own pension funds. It is true that management can not influence its pension funds for the benefit of the corporation. Moreover, the corporation cannot direct the "named fiduciary" to buy or sell, vote on proxies, etc. However, the board of a corporation, a committee of the board or an officer of the corporation, among others, can be the "named fiduciary" of the corporation's pension plan, and such "named fiduciaries" have the responsibility for managing the pension fund. It is, in fact, generally the case that such a party, very often a committee of the board, is the "named fiduciary". The "named fiduciary" generally will hire one or more investment managers to manage portions of the money.

The "named fiduciary" typically hires investment managers based in part on a proposed strategy, e.g. active strategy, long term investing, etc, and periodically reviews what has happened and agrees upon the strategy for the period thereafter. Presumably these investment advisors are hired and strategies are agreed upon in the context of the ERISA responsibilities of the "named fiduciary". That ERISA responsibility is, of course, to consider options and determine a strategy in the economic interest of the participants and beneficiaries. In brief, many "named fiduciaries" are committees of the board, "named fiduciaries" are responsible for determining an investment approach, many "named fiduciaries" settle upon a balance time horizon approach, and

finally those decisions appear generally appropriate under ERISA.

The Problem, A Caution

I will set forth today the position of management versus pension funds. I will do so somewhat starkly to make a point but, in fact, there is a range of views and approaches by both management and labor. Moreover, the issues here are just part of a much broader set of matters, e.g. LBOs and takeovers, management's relationship with shareholders generally, etc.

Corporate Management View of the Relationship

Corporate management has a view on why the relationship between management and pension funds is not stable. Corporate management often complains as follows: pension funds and their investment managers view their corporate investments simply as the purchase of stocks, rather than seeing themselves as investing in a going business. They assert that the focus on stocks rather than the underlying business causes pension funds and their investment managers to have too short a performance time horizon. As a result they may buy and sell stocks too often and for superficial reasons. They argue that too many investment managers and their staff are super aggressive MBAs whose personal achievement time horizon is too short. This is accented by many "named fiduciaries" and pension funds demanding short term excellent performance from investment managers. Management notes that even if the pension fund takes a balance time horizon view, its investment managers will feel pressure for quarter by quarter performance since that is, in part, how they will sell themselves to future clients. Some say pension funds and investment managers use simplistic performance criteria for judging the progress of enormous corporations. They are eager for good results and easily disappointed by momentary setbacks in business operations. The investment community as a group is too influenced by performance fads and trendy industries. In short, Wall Street is on a very different time horizon than Main Street.

Corporate America often says pension funds give lip service to all the right corporate goals. They support more research and development, long term relationship-building with employees and customers, market share efforts, etc. But they still demand quarterly earnings gains and high share prices while they wait and that is sometimes not possible.

For corporate America the alleged lack of loyalty of pension funds when managements are confronted by hostile raiders is the test that is often failed. Pension funds, it is said, want a better stock price -- however and whenever it is available. They have no long-term commitment to a company's progress.

Corporate management argues that you cannot run a business with long-term objectives when you are constantly looking over your shoulder for someone about to offer flighty stockholders a better

deal. You end up operating your business at the margin, heavily leveraged and stretched to the breaking point, with no room for error or flexibility. No organization can run at top speed every day.

Corporate management notes that pension funds, especially public pension funds, sometimes include social issues in their agenda for corporate performance. Some managers argue that many of these issues politicize what should be a sound business and economic decision-making process. Suddenly, the corporation must address goals that belong in the political arena, goals that in fact may detract from the best economic performance for shareholders including the pension funds.

Management argues that they already talk a great deal to pension funds. Also it is hard to know who represents who since no one pension fund owns very much of a particular company and a "leader" does not necessarily represent alot of others. Many, perhaps most, large publicly held companies feel that they have to treat all shareholders about the same because of, among other reasons, potential SEC problems, and some pension funds, especially some public pension funds, are asking for special treatment.

A very interesting perspective is provided by a very senior CEO who believes that pension funds should take a balanced and longer term view in their investments because of their long term obligations and the stake which they have in corporate America's success. But he says that pension funds probably are going to be traders to some degree because of the large number of corporations in which they invest. Moreover, management cannot insist on a special long term commitment on the part of pension funds and argue at the same time against giving the funds a special role in corporation decisions. He thinks that large public companies cannot deal in a special way like this with only some of their shareholders. Accordingly, he believes that the relationship between pensions and management cannot be expected to change much, and probably should not, beyond perhaps a concentrated effort by management to respond to the interest of all shareholders and communicate with them. He says that where the performance of the company and its management is inadequate, it is reasonable to expect the shareholders to disinvest or try to change the management. He seems to say that, to the extent that there is a problem between pension funds and management, it is partly because some managers are not responding to the economic interests of all shareholders. This CEO and many other CEOs feel that there is pressure to take a short term view but they feel that stability in the pension fund - management relationship is not the central problem. Rather they point to conditions that encourage takeovers and LBOs, e.g. availability of hugh amounts of takeover money, full deductibility of interest in highly leverage situations, etc.

Pension Plan View of the Relationship

Pension plan managers reply to those management claims as follows: While pension funds as a group may own a large percentage of the stock of a corporation, each individual fund rarely owns more than one or two percent. Moreover, an individual fund may own one or two percent of the outstanding share of many companies. This type of diversified holding must be managed as an portfolio and not directly as the ownership of a business.

Pension plans and their investment managers point out that "named fiduciaries" charged with pension plan responsibility (and usually part of management) look at performance quarter by quarter, regardless what anyone tries to say, and that review translates into quarter by quarter horizons.

Also, some pension funds say that the volatility of the stock market, driven by the lure of hugh gains through takeovers, mergers and LBOs pulls attention to the short term, and that only so much restraint can be expected from anyone in these conditions.

Some pension plans say they are not staffed or organized to participate as owners of the companies in which they invest. They certainly are not set up to serve on a number of boards of directors and besides such involvement might limit their ability to sell if they thought it appropriate. Moreover, how many company objectives and strategies of companies could a pension plan help develop? The plan's only option is to evaluate the detailed programs of managers and directors after they are established. Managers set the business agenda and pension funds respond.

Pension funds point out that fairly often a pension fund has different investment advisors with different strategies, e.g. some with long term approaches and others with a short term view. This "balanced" approach makes sense for the individual fund but, of course, it is these short term investment managers that corporate managers complain about. In any case many, perhaps most, large pension funds are set up so that their investment managers have broad authority to implement an agreed upon strategy. (Some, in fact, suggest that this set of issues be viewed as a triangle with management, pension funds and investment managers each having a different perspective.)

Pension plans believe that corporate managements are rarely confused about the type of performance that pension plans expect. Protests to the contrary are sometimes a cover for ineffective leadership. Pension plans want the kind of performance any investor would want from a well-run business.

While they can live without progress every quarter, they do expect periodic gains. Long term growth, particularly in large corporations, has got to be achieved with some regularity. Earnings disruptions that are explained and addressed promptly may not be a problem. It is consistently poor or erratic performance without serious remedial action and good explanations that dismays all investors.

Pension plans have few options in dealing with corporate managements that do not perform well. It is argued that the proxy solicitation process for reforms or director changes is so costly and dominated by management that it is not cost effective compared to just selling your stock. When an acquirer comes along, it is a gift to have someone who will take you out of the stock at a very favorable price. Corporate management generally consults and is sensitive to the concerns of major individual and corporate shareholders. In that spirit, some pension groups have tried recently to impact on major corporate decisions. Some of corporate America has not been very interested and sometime hostile to these ideas. Pension funds agree that the Wall Street Walk is at times very disruptive but the corporate management generally does not provide a option.

Resolving the Differences

There are many issues on either side of this debate, but those I have mentioned sum up the essence of the problem. They certainly give a flavor of the differences. We should be careful not to overemphasize the differences that exist, but a certain amount of tension between corporate America and institutional investors is essential, if businesses are to be attentive to maximizing their opportunities. At the same time, pension owners/investors and managers should come to a better working understanding for the economic benefit of everyone and the good of the country.

It is interesting to look at the role of stockholders in Germany and Japan. Banks and other corporations often own controlling blocks of stocks. In those situations, stockholders frequently have a major role in key corporate decisions. Often that role is very informal. It can be argued that knowledgeable shareholders in Japan and Germany who closely monitor corporations have an earlier and less disruptive impact on corporations that start to get into trouble. I am not arguing in favor of these interlocking relationships, indeed these relationships in Japan are probably part of our trade problem. In addition, our laws would and should preclude some of such concentrated holdings in the U.S., but there may be some things to learn here. Some of the same lessons could also be drawn from a somewhat comparable situation in many U.S. corporations with large and sophisiticated non-institutional shareholders.

I am not trying to suggest the amount or exact type of

relationship between pension funds and corporate management but there may be options to the Wall Street Walk. For example, some argue that the corporate governance process should work to provide that option for truly important corporate issues. The theory is that management cannot expect shareholders to be loyal without some input. Certainly management must really deal with pension funds, keeping in mind the amount of shares they vote. Management usually deals with other major shareholder groups in that spirit. As a part of the relationship with pension funds, management will want to make a great effort to present their long range plans and focus on the feedback. Management will, of course, have more to sell if their companies are well run. Management must sell its performance and plans to its shareholders just like it sells its goods to its customers, and there is a message if the shareholders don't buy the program.

The pressure of corporate governance reform from pension funds is, in part, because some feel that at least some management does not deal sufficiently with the pension funds concerns.

Management can expect that the pressure will remain and perhaps increase on corporate governance to the extent that management appears not to respond to the concerns of these major shareholders.

That being said, a more basic question may be how the owners - all of the shareholders - feel that management is responding to their interests. Management of large public corporations was effectively insulated from the shareholders over the past several decades but that time is largely gone. Management is living in that new reality and it can be tough.

As to pension funds, they need to have more long-term commitment as investors. Pension funds have such a big stake that it no longer makes sense for them to be only traders. That mind set comes from a different period of history when pension funds were small players. Today they have a major interest in corporate America and in management taking a balance time horizon approach to running companies. The role of investor may well require some pension plans to change how they operate. Certainly, some pension funds will need to spend more time trying to understand corporate management and their long-term plans, e.g. attend more analyst meetings, know and communicate more with the analysts for the industry, communicate more with the companies and raise business strategy questions, etc.

Both sides have useful things to say to each other, things that are not always being heard now. Both sides have legitimate needs and interests that should be respected.

I should note that there is in fact some of what is needed already going on in both the pension community and in management

but further steps are needed.

As I stated above, I have contrasted somewhat starkly the views of pension funds versus management. Many pension people feel that the recent move toward passive investment will deal in part with rapid turnovers and there clearly are many pension funds that take a very responsible long term view. Moreover, Bruce Atwater, CEO of General Mills and a leader on these issues in the corporate community, and others feel that there is already a great deal of communication between some pension funds and some companies.

Also, corporate pension plans have generally been less worried about these issues than public pension funds.

Moreover, we should keep in mind that the relationship of pension funds and management is only part of a whole range of economic forces and perhaps not a central factor.

This lack of stability in the relationship between pension funds and management is basically a problem that needs to be worked out between the private parties. It is not something the government should try to dictate. It is true that we in the government should continue to watch the matter and perhaps at the margins we can help.

In conclusion, the pension funds with their long term liabilities are in an excellent position to take a balanced view - short and long term - of their investments. Also given the size and growth of pension funds, corporate America probably will and should pay more attention to pension funds' economic concerns. Stability in the relationship between these parties is important for the ability of managers to take a long term view and hence for the competitive position of the U.S.

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.

April 4, 1989

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued April 13, 1989. This offering will result in a paydown for the Treasury of about $325 million, as the maturing bills are outstanding in the amount of $14,724 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 10, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated January 12, 1989, and to mature July 13, 1989 (CUSIP No. 912794 SQ 8), currently outstanding in the amount of $7,665 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 7,200 million, to be dated April 13, 1989, and to mature October 12, 1989 (CUSIP No. 912794 TA 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 April 13, 1989. In addition to the maturing 13-week and 26-week bills, there are $ 9,062 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 $ 1,543 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $1,903 million as agents for foreign and international monetary authorities, and $6,433 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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

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FOR IMMEDIATE RELEASE
April 5, 1989

CONTACT: LARRY BATDORF
(202) 566-2041

**TREASURY RELEASES SIXTH REPORT
ON U.S. CORPORATIONS IN PUERTO RICO**

The Treasury Department today released its sixth Report on The Operation and Effect of the Possessions Corporation System of Taxation. Possessions corporations are companies incorporated in one of the fifty States or the District of Columbia that are generally exempt under section 936 of the Internal Revenue Code from Federal tax on their income from Puerto Rico, Guam, and certain other U.S. possessions. These corporations are also generally exempt under industrial tax incentive programs from all or a portion of the otherwise applicable income tax imposed by Puerto Rico and the possessions.

The tax data in the report released today relate to returns with fiscal years ending after June 30, 1983 and on or before June 30, 1984. It is therefore the first Possessions Report that presents evidence on the impact of the provisions of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

Since over 99 percent of the income of all possessions corporations is derived from Puerto Rico, the body of the report deals with the operation and effect of the possessions corporation system in Puerto Rico.

Among the principal findings of this report are:

-- The estimated tax savings to U.S. corporations from the possessions corporation provisions were $1.6 billion in 1983 (Table 4-5).

-- Possessions corporations in manufacturing industries in Puerto Rico employed approximately 89,000 persons in 1983. This represented 12 percent of total employment in Puerto Rico and 62 percent of all employees in Puerto Rico's manufacturing sector. (Tables 4-6 and 3-3.)

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-- Average tax savings per employee were $18,523, or 125 percent of average compensation. Tax saving per employee ranged from 265 percent of compensation in pharmaceuticals to 31 percent of compensation in textiles (Table 4-6).

-- TEFRA appears to have reduced the tax benefits received by possessions corporations. In a group of firms with matched 1982 and 1983 tax returns that were required to use the TEFRA rules, tax benefits declined from 137 percent of compensation in 1982 to 101 percent in 1983 (Table 5-4).

-- The pharmaceutical industry derived 46 percent of the total tax savings and provided 15 percent of the employment of possessions manufacturing corporations in 1983. (Table 4-7.)

-- Possessions corporations also held about $15 billion of exempt financial assets in Puerto Rico at year-end 1986. It is very difficult to identify any significant reduction in interest rates or increase in real investment resulting from the tax exemption for financial assets (Tables 6-1, 6-2, 6-3 and 6-4).

An appendix to the Report summarizes the possessions corporation system of taxation as it applies to American Samoa and Guam and describes the tax exemption for U.S. corporations operating in the Virgin Islands in accordance with section 934(b) of the Internal Revenue Code.

Copies of the Report, GPO Stock No. 048-000-00406-7, are available for purchase from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20401.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE 00:! 5310 April 11, 1989

Edith E. Holiday
General Counsel
Department of the Treasury

Edith (Ede) E. Holiday was appointed General Counsel for the Department of the Treasury on March 18, 1989. She was confirmed by the United States Senate on March 17, 1989. Ms. Holiday had served since October 19, 1988 as Assistant Secretary of the Treasury for Public Affairs and Public Liaison as well as Counselor to the Secretary.

Prior to joining the Department, Ms. Holiday was Chief Counsel and National Financial and Operations Director for the Bush/Quayle 88 Presidential Campaign. Previously she served as Director of Operations for George Bush for President and Special Counsel for the Fund for America's Future.

In 1984 and 1985, Ms. Holiday was Executive Director for the President's Commission on Executive, Legislative and Judicial Salaries. She practiced law with the firm of Dow Lohnes & Albertson in 1983 and 1984 and with the firm of Reed Smith Shaw & McClay from 1977 to 1983. Ms. Holiday also served as Legislative Director for U.S. Senator Nicholas F. Brady in 1982.

Ms. Holiday graduated from the University of Florida (B.S., 1974; J.D. 1977). Born in Middletown, Ohio, she resides in Atlanta, Georgia and is married to Terrence B. Adamson. They have a two month old daughter, Kathlyn. Ms. Holiday is the daughter of Mr. and Mrs. Harry Holiday, Jr., formerly of Middletown, Ohio, currently of Delray Beach, Florida and Highlands, North Carolina.

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TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
April 5, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION $7,000 MILLION OF 7-YEAR NOTES

The Department of the Treasury will auction $7,000 million of 7-year notes to refund $3,238 million of 7-year notes maturing April 15, 1989, and to raise about $3,750 million new cash. The public holds $3,238 million of the maturing 7-year notes, including $650 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $7,000 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, Federal Reserve Banks for their own accounts hold $110 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

NB-211

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 7-YEAR NOTES
TO BE ISSUED APRIL 17, 1989

April 5, 1989

<u>Amount Offered</u>:

To the public	$7,000 million

<u>Description of Security</u>:

Term and type of security	7-year notes
Series and CUSIP designation	F-1996 (CUSIP No. 912827 XK 3)
Maturity date	April 15, 1996
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 15 and April 15
Minimum denomination available ..	$1,000

<u>Terms of Sale</u>:

Method of sale	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None

<u>Payment Terms</u>:

Payment by non-institutional investors	Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts ...	Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions	Acceptable

<u>Key Dates</u>:

Receipt of tenders	Wednesday, April 12, 1989, prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):	
a) funds immediately available to the Treasury ..	Monday, April 17, 1989
b) readily-collectible check ..	Thursday, April 13, 1989

TREASURY NEWS

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

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APR 1[illegible] 1989

DEPARTMENT [illegible]

FOR IMMEDIATE RELEASE

APRIL 6, 1989

CONTACT: ART SIDDON
(202) 566-2041

M. PETER McPHERSON
DEPUTY SECRETARY
TO LEAVE TREASURY

Secretary of the Treasury Nicholas F. Brady announced that M. Peter McPherson, Deputy Secretary of the Treasury, will leave the Treasury Department on April 6. Mr. McPherson leaves Treasury to join Bank of America, where he will become an Executive Vice President and the Director of Debt Restructuring. He will be responsible for all bank negotiations of restructured developing country debt and for the management of the bank's debt equity swaps. He will serve as the bank's primary spokesman on developing country debt issues and will serve on the bank's Senior Management Council.

In announcing his departure, Secretary Brady said, "Peter has been an active leader at Treasury. He has personally been involved in critical matters including the U.S.-Canada Free Trade Agreement and GATT. Peter worked extensively on competitiveness issues, especially the issues concerning decision making horizons of managers and the role of pension funds. His experience and wisdom will be missed. I wish Peter the best in the private sector and am grateful for his work at Treasury."

Mr. McPherson, confirmed as Deputy Secretary of the Treasury in August 1987, was involved in the full range of issues in the Department. As Treasury's number two official, he has taken a special interest in trade, tax, and international issues. He was one of the three negotiators in the final weeks of the U.S.-Canada Free Trade Agreement. He was a member of the Farm Credit Assistance Board and a member of the Board of the Federal Financing Bank.

Mr. McPherson served as Acting Secretary of the Treasury during the transition period between Secretary Baker and Secretary Brady.

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From 1981 to 1987, Mr. McPherson served as Administrator, Agency for International Development and Chairman of the Board of the Overseas Private Investment Corporation. As Administrator, he was in charge of the U.S. response to the Great Famine in Africa in 1984-85 when the U.S. delivered more than 2 million tons of food to Africa over a 12 month period. He was General Counsel to the 1980 Reagan-Bush Transition.

Before joining the Reagan Administration, Mr. McPherson was a partner and head of the Washington office of an Ohio law firm, Vorys, Sater, Seymour & Pease. He served as Special Assistant to the President and Deputy Director of Presidential Personnel in the Ford White House.

TREASURY NEWS

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

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FOR RELEASE AT 3:00 PM
April 6, 1989

Contact: Peter Hollenbach
(202) 376-4302

TREASURY ANNOUNCES ACTIVITY FOR SECURITIES IN THE STRIPS PROGRAM FOR MARCH 1989

The Department of the Treasury announced activity figures for the month of March 1989 of securities within the Separate Trading of Registered Interest and Principal of Securities program, (STRIPS). The principal outstanding for eligible securities was $326,960,142,000 with $247,755,712,000 held in unstripped form and $79,204,430,000 held in stripped form. The amount reconstituted in March was $1,627,280,000. The attached table gives a breakdown of STRIPS activity by individual loan description.

The Treasury now reports reconstitution activity for the month instead of the gross amount reconstituted to date. These monthly figures are included in Table VI of the Monthly Statement of the Public Debt, entitled "Holdings of Treasury Securities in Stripped Form." These can also be obtained through a recorded message on (202) 447-9873.

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TABLE VI—HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, MARCH 31, 1989
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding			Reconstituted This Month
		Total	Portion Held in Unstripped Form[1]	Portion Held in Stripped Form[1]	
11-5/8% Note C-1994	11/15/94	$6,658,554	$5,578,554	$1,080,000	$20,800
11-1/4% Note A-1995	2/15/95	6,933,861	6,202,821	731,040	24,000
11-1/4% Note B-1995	5/15/95	7,127,086	5,434,926	1,692,160	40,000
10-1/2% Note C-1995	8/15/95	7,955,901	7,005,101	950,800	—0—
9-1/2% Note D-1995	11/15/95	7,318,550	6,782,550	536,000	5,600
8-7/8% Note A-1996	2/15/96	8,410,929	8,105,329	305,600	—0—
7-3/8% Note C-1996	5/15/96	20,085,643	19,989,643	96,000	100,800
7-1/4% Note D-1996	11/15/96	20,258,810	19,987,610	271,200	30,400
8-1/2% Note A-1997	5/15/97	9,921,237	9,776,037	145,200	—0—
8-5/8% Note B-1997	8/15/97	9,362,836	9,362,836	—0—	—0—
8-7/8% Note C-1997	11/15/97	9,808,329	9,792,329	16,000	—0—
8-1/8% Note A-1998	2/15/98	9,159,068	9,159,068	—0—	—0—
9% Note B-1998	5/15/98	9,165,387	9,165,387	—0—	—0—
9-1/4% Note C-1998	8/15/98	11,342,646	11,342,646	—0—	—0—
8-7/8% Note D-1998	11/15/98	9,902,875	9,902,875	—0—	—0—
8-7/8% Note A-1999	2/15/99	9,719,678	9,719,678	—0—	—0—
11-5/8% Bond 2004	11/15/04	8,301,806	2,764,206	5,537,600	48,000
12% Bond 2005	5/15/05	4,260,758	1,725,608	2,535,150	—0—
10-3/4% Bond 2005	8/15/05	9,269,713	6,506,913	2,762,800	127,600
9-3/8% Bond 2006	2/15/06	4,755,916	4,755,916	—0—	—0—
11-3/4% Bond 2009-14	11/15/14	6,005,584	1,409,584	4,596,000	79,200
11-1/4% Bond 2015	2/15/15	12,667,799	2,894,199	9,773,600	164,480
10-5/8% Bond 2015	8/15/15	7,149,916	1,946,716	5,203,200	—0—
9-7/8% Bond 2015	11/15/15	6,899,859	3,258,259	3,641,600	—0—
9-1/4% Bond 2016	2/15/16	7,266,854	5,242,054	2,024,800	217,600
7-1/4% Bond 2016	5/15/16	18,823,551	13,123,551	5,700,000	244,000
7-1/2% Bond 2016	11/15/16	18,864,448	9,361,168	9,503,280	—0—
8-3/4% Bond 2017	5/15/17	18,194,169	8,238,169	9,956,000	—0—
8-7/8% Bond 2017	8/15/17	14,016,858	9,154,458	4,862,400	120,000
9-1/8% Bond 2018	5/15/18	8,708,639	5,811,039	2,897,600	104,800
9% Bond 2018	11/15/18	9,032,870	6,033,670	2,999,200	300,000
8-7/8% Bond 2019	2/15/19	9,610,012	8,222,812	1,387,200	—0—
Total		326,960,142	247,755,712	79,204,430	1,627,280

[1] Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form. The amounts in this column represent the net affect of stripping and reconstituting securities.

Note: On the 4th workday of each month a recording of Table VI will be available after 3:00 pm. The telephone number is (202) 447-9873.
The balances in this table are subject to audit and subsequent adjustments.

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE

April 6, 1989

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,011 million of 52-week bills to be issued April 13, 1989, and to mature April 12, 1990, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	8.73%	9.48%	91.173
High -	8.75%	9.51%	91.153
Average -	8.75%	9.51%	91.153

Tenders at the high discount rate were allotted 97%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 32,390	$ 32,390
New York	22,079,130	7,917,030
Philadelphia	24,475	24,475
Cleveland	55,565	55,565
Richmond	54,895	54,895
Atlanta	29,595	29,595
Chicago	1,565,715	155,825
St. Louis	37,770	37,740
Minneapolis	16,065	16,065
Kansas City	65,140	63,110
Dallas	31,270	21,270
San Francisco	1,013,950	330,900
Treasury	272,565	272,465
TOTALS	$25,278,525	$9,011,325
Type		
Competitive	$21,518,125	$5,250,925
Noncompetitive	1,030,400	1,030,400
Subtotal, Public	$22,548,525	$6,281,325
Federal Reserve	2,500,000	2,500,000
Foreign Official Institutions	230,000	230,000
TOTALS	$25,278,525	$9,011,325

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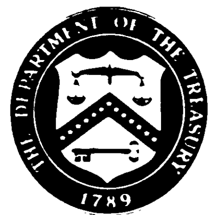
TREASURY NEWS 

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

FOR IMMEDIATE RELEASE
April 7, 1989

CONTACT: Larry Batdorf
(202) 566-2041

UNITED STATES AND GUAM SIGN TAX IMPLEMENTATION AGREEMENT

The Treasury Department announced today that the United States and Guam have signed a tax implementation agreement to exchange tax information and provide mutual assistance in tax matters. The agreement, when effective, will replace and expand existing tax agreements between the United States and Guam. The agreement was signed by the Governor of Guam, Joseph F. Ada, the Director of the Guam Department of Revenue and Taxation, Joaquin G. Blaz, and by Acting Assistant Secretary for the Treasury (Tax Policy) John G. Wilkins. The Lieutenant Governor of Guam, Frank F. Blas, who is also Chairman of the Guam Tax Reform Commission, brought the agreements to Washington for signature by Mr. Wilkins.

The agreement is effective January 1, 1991, or such earlier date as the two governments agree. Sections 1271 and 1277 of the Tax Reform Act of 1986 required the United States and Guam to put into effect a tax implementation agreement before certain provisions of the Tax Reform Act that concern Guam will take effect.

The agreement with Guam is similar to the tax implementation agreements signed by the United States with the Virgin Islands in 1987 and with American Samoa in 1988. The United States is continuing to negotiate a tax implementation agreement with the Commonwealth of the Northern Mariana Islands. In the case of each of these possessions, certain provisions of the Tax Reform Act of 1986 are not effective until a tax implementation agreement is in effect.

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THE SECRETARY OF THE TREASURY
WASHINGTON

April 4, 1989

Dear

Thank you for your leadership in moving with dispatch on the Administration's Financial Institutions Reform, Recovery, and Enforcement Act of 1989. Your announced schedule for mark-up of the President's legislation and your continuing efforts to move the legislation for his early signature are truly in the public interest. Your dedication to prompt action will translate into substantial savings for the U.S. taxpayer.

In my view it is critical that the fundamental structure of the Administration's plan -- reform, financing and enforcement -- generally remain intact. On the financing issue, we have provided adequate funding through an equitable and balanced system of self-help contributions from the savings and loan industry and Treasury funding.

There is an important reason to adhere to our financing proposal: the intent and integrity of the Gramm-Rudman-Hollings process. Proposals to concentrate the financial burden solely in this year's budget would mean that we far exceed the Gramm-Rudman-Hollings deficit reduction target. Any effort to sidestep this process could be viewed as gimmickry, could create an unfortunate precedent, and could render essential budget discipline a sham. Our plan scores all Treasury payments in the year expended and lives within the President's budget deficit reduction program.

My meetings over the weekend with our major foreign trading and financial partners only reinforce in my mind the importance of the Gramm-Rudman-Hollings discipline to our international economic standing. Our international friends are concerned about our ability to bring down the budget deficit and will be watching carefully to see that we keep our commitments. If we fail to honor Gramm-Rudman-Hollings, the effect on financial markets could raise government borrowing rates; if these rates increase by as little as two basis points, the resulting increased interest cost would dwarf any potential cost savings derived from direct Treasury financing of the savings and loan plan.

Finally, if we open up Gramm-Rudman-Hollings, one sure consequence for the S&L package will be something none of us can afford -- delay -- and delay translates into a higher total cost associated with resolving the S&L problem.

As for reform, we believe that deposit insurance protection for the public works best when sufficient private capital is up front and at risk, ahead of the deposit insurer and the taxpayer. Regulatory standards for thrifts must be brought up to the level of banks. We have for too long allowed thrifts to grow without the discipline of prudent capital levels and meaningful accounting standards. The result has been the current thrift crisis. That is why we have set June 1991 as an appropriate time to have risk-based capital standards in place for S&Ls that are no less stringent than capital standards for national banks. As you know, the risk-based capital formula encourages the holding of mortgages and mortgage-backed securities.

One of the reasons we face the problems we have today is that savings and loans have had either regulatory or statutory capital forbearance since the early 1980s. In this context, a 1991 date is reasonable and necessary to restore public confidence in the savings and loan industry. I urge you to resist entreaties to postpone the effective date of the capital requirements; it didn't work in the past.

To be clear, 1991 is not a date after which non-complying S&Ls must face liquidation. Instead, after that date a financial institution must have a suitable business plan to build capital before it can grow. The definition of capital must be meaningful. We should not allow phantom capital, as would occur if we allowed deferred loan losses to count as capital, allowed the double accounting of subsidiary capital, or counted subordinated debt as tier 1 capital. The GAAP capital standard must replace so-called regulatory accounting principles (RAP). We would, however, be pleased to work with Congress on appropriate language to ensure equitable treatment of goodwill resulting from a supervisory acquisition, assuming that the other elements of the Administration's capital rule are maintained intact.

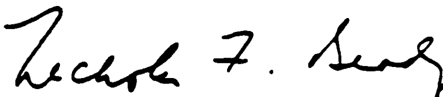
The general regulatory and supervisory reform components of the President's legislation are equally important. One other potential improvement in the regulatory provisions concerns easing restrictions immediately on bank holding company acquisition of savings and loan associations. This would help bring more private capital into the industry. We would be pleased to work with the Congress in this area, as well. We believe the delay that would come from a protracted debate about competitive products and services offered by different financial institutions would be counterproductive.

We feel strongly that sanctions for wrong doing and improper practices in financial institutions be strengthened to maintain the credibility of the other reforms we all agree are necessary. As President Bush observed, and the General Accounting Office confirmed, unconscionable risk-taking, fraud, and outright criminality have been important factors in the erosion of the strength of the financial institution industry. The public has asked that we make every effort to recover assets diverted from these institutions and put those guilty of criminal activity behind bars.

Finally, I must again stress the critical need for immediate action by the Congress. Delay is our enemy. There will be other opportunities to address other issues not contained in this legislation.

Our goal as stated by the President, and which I know you share, is "to resolve this threat to the American financial system permanently, and to do so without delay." Let us move forward together quickly toward that goal.

Sincerely,



Nicholas F. Brady

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
April 10, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,207 million of 13-week bills and for $7,224 million of 26-week bills, both to be issued on April 13, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 13, 1989			:	26-week bills maturing October 12, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.70%	9.02%	97.801	:	8.77%	9.30%	95.566
High	8.72%	9.04%	97.796	:	8.78%	9.32%	95.561
Average	8.71%	9.03%	97.798	:	8.78%	9.32%	95.561

Tenders at the high discount rate for the 13-week bills were allotted 63%.
Tenders at the high discount rate for the 26-week bills were allotted 99%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 49,460	$ 49,190	:	$ 39,500	$ 39,500
New York	23,753,585	5,963,755	:	20,946,820	6,050,290
Philadelphia	28,280	28,280	:	18,880	18,870
Cleveland	54,080	54,080	:	46,395	46,325
Richmond	63,980	63,980	:	50,125	50,125
Atlanta	44,565	44,565	:	40,520	40,520
Chicago	1,325,115	155,265	:	1,317,795	113,195
St. Louis	55,010	35,010	:	39,300	31,300
Minneapolis	12,840	12,840	:	12,275	12,275
Kansas City	52,985	52,985	:	66,010	66,010
Dallas	45,075	35,075	:	33,755	23,755
San Francisco	813,050	101,050	:	784,950	231,450
Treasury	611,070	611,070	:	500,395	500,395
TOTALS	$26,909,095	$7,207,145	:	$23,896,720	$7,224,010
Type					
Competitive	$23,172,645	$3,470,695	:	$19,330,860	$2,658,150
Noncompetitive	1,503,855	1,503,855	:	1,200,925	1,200,925
Subtotal, Public	$24,676,500	$4,974,550	:	$20,531,785	$3,859,075
Federal Reserve	2,032,830	2,032,830	:	1,900,000	1,900,000
Foreign Official Institutions	199,765	199,765	:	1,464,935	1,464,935
TOTALS	$26,909,095	$7,207,145	:	$23,896,720	$7,224,010

An additional $86,035 thousand of 13-week bills and an additional $616,465 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 11, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued April 20, 1989. This offering will result in a paydown for the Treasury of about $22,800 million, as the maturing bills total $37,200 million (including the 248-day cash management bills issued August 15, 1988, in the amount of $7,021 million and the 17-day cash management bills issued April 3, 1989, in the amount of $15,506 million). Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, April 17, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated January 19, 1989, and to mature July 20, 1989 (CUSIP No. 912794 SR 6), currently outstanding in the amount of $7,614 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated April 20, 1989, and to mature October 19, 1989 (CUSIP No. 912794 TB 0).

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

The bills will be issued for cash and in exchange for Treasury bills maturing April 20, 1989. 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 $4,647 million as agents for foreign and international monetary authorities, and $4,314 million for their own account. These amounts represent the combined holdings of such accounts for the four 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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.

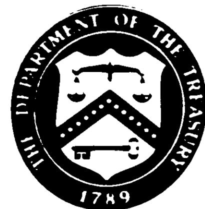
Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments 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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

10/87

TREASURY NEWS



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

FOR IMMEDIATE RELEASE
April 12, 1989

CONTACT: LARRY BATDORF
(202) 566-2041

TREASURY RELEASES REPORT ON THE TAXATION
OF AMERICANS WORKING ABROAD

The Treasury Department has released a report on Taxation of Americans Working Overseas - The Operation of the Foreign Earned Income Exclusion in 1983.

U.S. citizens and residents employed in a foreign country for 11 out of 12 months and U.S. citizens who are bona fide residents of a foreign country for the full tax year may claim an exemption from Federal income tax of up to $70,000 per year of foreign earnings plus housing costs in excess of a base amount. The tax data in this report relate primarily to 1983 income. At that time, the maximum annual exclusion of foreign earned income was $80,000 plus reasonable housing costs in excess of $6,604.

Among the principal findings of this report are:

-- Approximately 154,000 returns claimed the foreign earned income exclusion in 1983. They reported $7.0 billion of foreign earned income, of which $6.0 billion was excluded from the tax base.

-- Fewer than one in five returns claimed relief for excess housing costs. For those that did, the relief was substantial; it averaged 30 percent of the average basic exclusion.

-- The estimated tax savings from the foreign earned income exclusion in 1983 was $1.0 billion.

-- Saudi Arabia was the most frequently reported tax home, accounting for 16 percent of the returns and 22 percent of the excluded income. Other principal tax homes were Germany, the United Kingdom, Canada, and Japan.

-- The principal fields of occupation reported were construction, engineering, petroleum or mining (21 percent of the individuals); education and religion (20 percent) and business management (15 percent).

Copies of the report, GPO Stock No. 048-000-00407-5 are available for purchase from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20401.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE
April 12, 1989

CONTACT: Office of Financing
202/376-4350

OOM 5310

RESULTS OF AUCTION OF 7-YEAR NOTES

The Department of the Treasury has accepted $7,020 million of $18,630 million of tenders received from the public for the 7-year notes, Series F-1996, auctioned today. The notes will be issued April 17, 1989, and mature April 15, 1996.

The interest rate on the notes will be 9-3/8%. The range of accepted competitive bids, and the corresponding prices at the 9-3/8% interest rate are as follows:

	Yield	Price
Low	9.38%*	99.975
High	9.40%	99.874
Average	9.39%	99.924

*Excepting 1 tender of $4,000.

Tenders at the high yield were allotted 38%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 32,782	$ 32,782
New York	16,515,361	6,334,941
Philadelphia	15,657	15,657
Cleveland	27,446	27,446
Richmond	23,021	17,996
Atlanta	36,871	36,871
Chicago	1,196,315	312,769
St. Louis	41,985	22,745
Minneapolis	16,665	16,658
Kansas City	29,579	29,579
Dallas	13,481	11,480
San Francisco	677,414	157,009
Treasury	3,855	3,840
Totals	$18,630,432	$7,019,773

The $7,020 million of accepted tenders includes $650 million of noncompetitive tenders and $6,370 million of competitive tenders from the public.

In addition to the $7,020 million of tenders accepted in the auction process, $600 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $110 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE April 12, 1989

U.S. Treasury to Sell Silver

The Department of the Treasury today announced that it has asked the Department of Defense, Defense Logistics Agency (DLA) to arrange public sales of Treasury-held silver beginning in May. This arrangement is pursuant to PL 100-440, dated September 22, 1988, and will result in the sale of 2 1/2 million fine troy ounces of silver each year for the next three fiscal years.

Two sales of approximately 1.25 million troy ounces each will be held in fiscal year 1989. Quarterly sales are planned for fiscal years 1990 and 1991.

The Secretary of the Treasury reserves the right to cancel any scheduled sale upon a determination that such a sale will severely disrupt the domestic market for silver or for any other reason deemed to protect the best interests of the government.

The silver to be offered is of various finenesses and is currently in storage at Mint facilities in San Francisco and West Point. Offered for sale from the San Francisco holdings is .999, .900, and .400 fine silver in bars weighing between 500 and 600 gross ounces. The West Point silver to be offered for sale is .999 fine silver in bars weighing approximately 1000 gross ounces. The balance of the assay in both offerings is copper.

The sales will be by competitive bids, per fineness categories, with all successful bidders paying the price bid for each ounce of silver. Bids will be accepted for a minimum purchase quantity as outlined in the Invitation for Bid. The government reserves the right to reject any or all bids. A bid deposit of 5 percent of the amount bid will be required.

Delivery will be made f.o.b. purchaser's conveyance at the San Francisco or the West Point Mint.

(more)

NB-220

Formal Invitations For Bid will be issued to provide complete terms and conditions of the sales. Firms or persons on DLA's precious metal mailing lists will be sent a copy of the Invitation For Bid within approximately 20 days. The first sale will be scheduled to take place approximately 20 days following issuance of the Invitation For Bid.

Requests for the Invitation For Bid and other inquiries should be directed to:

Defense Logistics Agency
Directorate of Stockpile Management
Stockpile Contracts Division
Disposal Branch - DLA-NCM
18th and F Streets, N.W.
Washington, D.C. 20405

Telephone: (202) 535-7225

TREASURY NEWS

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STATEMENT OF
DANA L. TRIER
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the Administration's views regarding the impact on small businesses of the non-discrimination rules of section 89 of the Internal Revenue Code. The Administration recognizes the difficulties posed by section 89 for small businesses. Because we are aware of these difficulties, the Administration supports continued efforts to simplify the application of section 89. We believe, however, that the Treasury Department and Internal Revenue Service cannot, by regulation, go any further in simplifying section 89 without enactment of legislation. The Treasury Department looks forward to assisting Congress in fashioning a legislative solution.

In the first part of my testimony, I will describe briefly the background of section 89, the policy rationale for its enactment and certain positions taken in the proposed regulations. Then I will discuss the principal problems with the application of the statute to small businesses. Finally, I will conclude by summarizing the Administration's position on modification of section 89.

Background and Policies

The enactment of section 89 had two basic effects. First, a uniform set of nondiscrimination rules was made applicable to the wide variety of employee benefit plans previously subject to different rules, such as group-term life insurance plans and self-insured medical plans. Second, nondiscrimination rules were made applicable to employer-provided health insurance, which was previously not subject to such rules. It is this latter effect of section 89 that is the most far reaching in its impact.

The Internal Revenue Code generally provides that the value of employer-provided health coverage is excluded from income. The primary purpose of this exclusion is to encourage employers to provide health coverage to their employees. The President's 1990 budget reports that the revenue loss tax expenditure for employer-provided health coverage in 1990 will be $29.6 billion.

Section 89 conditions this tax benefit by providing that employer-provided health coverage may be excluded from the income of highly compensated employees only if coverage is also provided on a nondiscriminatory basis to nonhighly compensated employees. In the event employer-provided health coverage is found to be discriminatory under section 89, the value of coverage is included in the income of highly compensated employees as wages.

The rationale for the conditions imposed by section 89 was that the tax expenditure for the exclusion from highly compensated employees' incomes is justified only to the extent employers provide nonhighly compensated employees health coverage generally comparable in value to the coverage received by highly compensated employees. The legislative history of the Tax Reform Act of 1986 indicates that Congress was concerned that the rules formerly applicable to certain employee benefits, particularly health insurance, did not require sufficient coverage of nonhighly compensated employees as a condition to the exclusion; the tax benefit afforded to highly compensated employees receiving employer-provided health coverage could not be justified without broader coverage being mandated.

Under section 89 an employer may choose to test its health plan to determine if the plan satisfies the nondiscrimination rules under one of two methods. Under the first method, a plan satisfies the rules if it satisfies two eligibility tests and one benefits test. The first eligibility test is that at least 50 percent of the plan participants must be nonhighly compensated. Satisfaction of the test ensures that the plan is not designed to benefit primarily highly compensated employees. The second eligibility test is that at least 90 percent of the nonhighly compensated employees must be eligible for a benefit at least equal to 50 percent of the greatest benefit available to a highly compensated employee. Satisfaction of this test ensures that minimum health coverage is available to most employees. The benefits test is satisfied if the average employer-provided benefit received by nonhighly compensated employees is at least 75 percent of the average employer-provided benefit received by highly compensated employees. This test is designed to ensure that nonhighly compensated employees actually benefit under the plan. In addition to meeting these tests, a plan may not contain any provision relating to eligibility to participate which (by its terms or otherwise) discriminates in favor of highly compensated employees.

Under the second method, a plan satisfies the nondiscrimination rules if it benefits 80 percent of the employer's nonhighly compensated employees. This method is available, however, only if the plan in question meets the general requirement that it not contain any discriminatory provision relating to eligibility to participate.

The definition of highly compensated employees under section 89 is the same as that used for other employee benefits. The Internal Revenue Code generally defines a highly compensated employee as any employee who, during the current year or the prior year, is one of the following: (i) a 5 percent owner; (ii) an officer receiving compensation in excess of $45,000; (iii) an employee receiving compensation in excess of $75,000; and (iv) an employee receiving compensation in excess of $50,000, who is among those 20 percent of employees receiving the greatest compensation from the employer. The Code provides that the relevant dollar amounts will be indexed for inflation.

When testing its health plans, an employer generally may exclude those employees who have not completed six months of service, those who are not yet age 21, those who normally work less than 17-1/2 hours per week, those who normally work not more than six months per year and nonresident aliens receiving no United States source income.

In recently promulgated regulations, the Treasury Department and Internal Revenue Service have attempted to be as flexible as legally possible to assist employers in bringing their plans into compliance with section 89. The proposed regulations implementing section 89 that were published on March 7, 1989 provide several transitional provisions that will enable employers to comply more easily with section 89 in 1989. First, the proposed regulations provide that employers who reasonably and in good faith comply with section 89 and its legislative history in 1989 will be treated as having satisfied section 89. In addition, employers may generally ignore facts in existence prior to July 1, 1989 when testing their plans for compliance in 1989. Employers who choose to take advantage of this relief merely annualize the benefits provided after July 1 to determine whether their plans are discriminatory. Lastly, the proposed regulations provide that employers who elect not to test whether their plans satisfy the 75 percent benefits test in 1989 may include in the income of certain of their highly compensated employees all of the employer-provided health coverage. This election relieves employers of most of the data collection and testing burdens. The highly compensated employees who must include in income all of the employer-provided health coverage are the 20 percent of such employees who receive the greatest compensation from the employer, but not less than ten employees nor more than 2,000 employees. This transitional provision is extended to 1990, except that the number of highly compensated employees who must include all of the employer-provided health coverage in income is greater.

Impact on Small Businesses

In formulating section 89, Congress was to some extent attentive to the particular situation of small businesses. Thus, for example, the 80 percent coverage test described above was originally intended, in part, to facilitate section 89 testing for small employers. The expectation underlying this test was that certain employers, especially small employers, might have very simple benefit structures under which substantially all employees are covered under one plan or a few very simple plans. It was thought that because of the availability of this test, many small businesses would not have difficulty in performing the nondiscrimination test; for such employers, a single, simpler test could be used, and the application of the three-part test would be unnecessary.

Nonetheless, it is clear that section 89 raises significant compliance problems for many small businesses as well as other employers. The principal difficulty arises when the employer is required to value the benefits actually provided under the plan. In some cases, valuation will not be necessary, as for instance, if an employer provides a single plan that satisfies the 80 percent test, or provides several plans that may be deemed comparable without benefit valuation and that together pass the 80 percent test. Valuation, however, may be required, for example, if more than one plan or option is provided.

To the extent valuation of benefits is required, those small businesses that provide health coverage to most of their employees may have particular difficulty in applying the nondiscrimination tests. In order to determine whether its health plans satisfy the three-part nondiscrimination test of section 89, an employer is required to test its plans on one day of the year, taking into account the facts in existence on such day. This test requires an employer to value the employer-provided health coverage actually received by each of its employees. In order to do this, an employer must identify those of its employees receiving employer-provided health coverage on the testing day and must ascertain the value of such coverage using any reasonable method, including the cost of coverage. If any highly compensated employee elects to receive health coverage on a day other than the testing day that has a value different from the value of the health coverage provided on the testing day, then the employer must take into account the values of the health coverage provided to the highly compensated employee in determining the value of the employer-provided coverage provided to such employee during the year.

In addition to the general problems of testing and valuation, we understand that one of the most significant problems that some small businesses encounter in applying these tests relates to the pricing of the health coverage offered by insurance companies. Many small businesses are required to pay insurance companies individual annually rated premiums rather than level-rate group

premiums. As a result, such a business is precluded as a practical matter from using the cost of health coverage as its value, because the cost of a highly compensated employee's coverage may be much greater than the cost of the coverage provided to a nonhighly compensated employee even though the same benefit schedule covers both employees. In addition, small businesses whose insurers refuse to provide health coverage to part-time employees may be unable to satisfy the nondiscrimination tests of section 89 if such businesses have a significant number of part-time employees. Finally, because small employers have a limited employee population, changes in the composition of the work force may have a significant impact on testing results.

Conclusion

The Administration fully understands the problems employers are experiencing in complying with section 89. It is clear that many of these problems were not fully understood when section 89 was drafted and that parts of the statute were ill-considered. At the same time, we fully recognize the competing policy objectives as well as revenue considerations. Accordingly, we want to give full latitude to the tax writing committees to consider these issues, and we intend to work with them to fashion appropriate revenue neutral legislation.

This concludes my prepared remarks. I would be pleased to respond to your questions.

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Statement by
The Honorable Nicholas F. Brady
Secretary of the Treasury
Before the
Subcommittee on Foreign Operations
Committee on Appropriations
U.S. House of Representatives
April 17, 1989

Mr. Chairman and Members of the Committee:

I welcome this opportunity to discuss with you the Administration's fiscal year 1990 budgetary proposals for the Multilateral Development Banks (MDBs) and the IMF's Enhanced Structural Adjustment Facility (ESAF).

I want to begin by commending the Committee and its staff for your excellent work last year in passing a separate, stand-alone foreign assistance appropriations bill. As you know only too well, Mr. Chairman, that was a signal achievement. The Administration attached considerable importance to that legislation, and we recognize and very much appreciate the constructive role played by you and members of the Committee. We also value highly the frank and informative bipartisan dialogue that was evident throughout the process leading up to enactment of the legislation.

For fiscal year 1990, the Administration is requesting $1,637 million in budget authority and $2,377 million under program limitations for subscriptions to the MDBs. It is worth emphasizing, Mr. Chairman, that exclusive of U.S. funding shortfalls from previous years, which comprise $313 million of this appropriation request, Administration requests for the MDBs have not increased since FY 1985. Thus, one might say that the MDBs have had their own nominal freeze in place for the past four years, and we are proposing to continue that this year.

For FY 1990 we are also seeking $150 million in budget authority to fund U.S. participation in the International Monetary Fund's Enhanced Structural Adjustment Facility (ESAF). The specific requests for each MDB "window" and the ESAF are presented in the annex at the end of my testimony.

Mr. Chairman, you have been an extremely strong advocate of the MDBs. You recognize, as I do, that these institutions are important vehicles for promoting U.S. economic, political, security, and humanitarian interests. Currently, the

international debt problem and the environment are of particular concern to all of us. Therefore, I regret that in your informal mark-up of the Administration's FY 1990 foreign assistance budget request, you suggested cuts of $303 million from the MDBs and $75 million from the ESAF. In particular, you eliminated funding for the World Bank and the Inter-American Development Bank because of dissatisfaction with the debt strategy. In light of efforts that are now under way to strengthen the strategy, I hope you will reconsider the level of funding for the MDBs and the ESAF.

PROPOSALS TO STRENGTHEN THE DEBT STRATEGY

As you know, the Administration has reexamined the international debt situation and the strategy for addressing debt problems. On March 10, I outlined a number of proposals to strengthen the strategy at a meeting of the Bretton Woods Committee. The new ideas build on the principles of the existing strategy, which have been reaffirmed by the international community as a valid basis for addressing debt problems. These principles call for restoration of growth through debtor economic reforms, the provision of external financial support by creditors, and the treatment of each country's needs and problems on an individual basis.

In concluding our review, however, we recognized that despite progress achieved in many areas through the previous strategy, serious impediments to a successful resolution of debt problems remain. In many debtor nations, growth has not been sufficient, nor has economic policy reform been adequate. Capital flight continues to drain resources from debtor country economies, and neither investment nor domestic savings have shown much improvement in a number of cases. Furthermore, while some progress has been made in reducing countries' debt through market mechanisms, the pace of debt reduction has been constrained. To be fair, Mr. Chairman, these are difficulties you have pointed out many times yourself.

Let me outline for you our proposals to address these problems. The approach we have suggested is intended to mobilize more effective external financial support for debtor countries' economic reform efforts. While recognizing the continued importance of new commercial bank lending, we feel that more emphasis should be placed on voluntary debt and debt service reduction, new investment, and flight capital repatriation.

In this new approach, we continue to rely upon the International Monetary Fund (IMF) and the World Bank to play central roles in addressing debt problems. The policy reforms fostered by these institutions to produce key macroeconomic and structural changes and sustained economic performance remain primary to any resolution of debt problems. In fact, we believe that IMF and World Bank capacity for promoting reform and

mobilizing financial resources can be more effectively harnessed to strengthen the international debt strategy. This can be achieved through additional emphasis on policies to promote foreign direct investment and flight capital repatriation, as well as redirection of some Fund and Bank resources to support debt and debt service reduction. I will elaborate on this below.

To facilitate the debt reduction process, constraints on diversified forms of financial support from the banking community need to be relaxed. In particular, the negotiation of a general waiver of the sharing and negative pledge clauses for each performing debtor would permit debt reduction negotiations between debtors and banks to go forward. Such waivers might have a three-year life in order to stimulate debt reduction within a relatively short time period. We expect these waivers to accelerate the pace of debt reduction, thus benefiting debtor nations and reducing new financing needs to more manageable levels. A variety of debt and debt service reduction transactions could be pursued, including debt/bond exchanges, cash buybacks, and non-collateralized interest reduction instruments. At the same time, effective debt/equity programs should be in operation in the debtor nations in order to permit continued conversions of external obligations into investment instruments.

We look to the banking community to continue to provide new lending as well, although the magnitudes required should be reduced by the debt and debt service reduction operation. New financing could include concerted lending, club loans, or trade credits -- all of which could involve a differentiation of new loans from old debt. Further, new investment and flight capital repatriation should play a role in meeting financing needs.

THE ROLE OF THE MDBS IN THE DEBT STRATEGY

Let me elaborate on how the Multilateral Development Banks relate to this enhanced debt strategy. As I mentioned, the World Bank will have to play a central role. This is true both with respect to its promotion of policy reforms and its mobilization of financial resources for the debtors.

Helping countries establish economic policies conducive to stronger growth will remain paramount. Sound policies must be established in the various sectors of debtor economies by, for example, liberalizing trade, reforming parastatals, developing financial markets, and relying on the private sector to help increase employment and efficiency. The World Bank has built impressive expertise in these areas and has made significant contributions to reforms in many countries.

In addition to providing advice and funding for vital structural reforms, however, the World Bank should place special

emphasis on measures to promote overall confidence in economic programs, improve the investment climate, and encourage repatriation of flight capital. By establishing sound economic policies, countries can make great strides in restoring investor confidence. Further, by liberalizing their financial sectors, debtor countries can expand the scope for investment by foreigners as well as their own nationals holding assets abroad.

We have proposed, moreover, that the World Bank extend its policy-based lending operations to provide support for voluntary debt reduction. In particular, we have suggested that the World Bank set aside a portion of participating nations' policy-based loans specifically to support debt reduction transactions -- thereby redirecting resources available from the World Bank's current capital. These funds could be used to collateralize debt-for-bond exchanges with a significant discount on outstanding debt, or to replenish foreign exchange reserves following a cash buyback.

We believe that the Bank should also make available limited interest support for transactions involving significant debt or debt service reduction. Such support, which could be structured so as to safeguard the financial position of the Bank, could be made available on a rolling basis for a limited period of time. Through these efforts, the Bank should help catalyze market activity which would ease debt service burdens, improve debtors' creditworthiness, and provide an impetus to growth.

Beyond ongoing and enhanced efforts to promote economic reforms and to facilitate an easing of debt burdens, the World Bank will continue its project-lending activities, which remain a key mechanism for stimulating growth. Such lending will still comprise about 75 percent of total lending. These loans cover a wide range of sectoral and development projects in borrowing countries, rehabilitating or restructuring existing enterprises and expanding productive capacity. They have financed country projects in agriculture and rural development, transportation, education, industry, energy, health and nutrition, water supply and sewerage, urban development, and telecommunications. This type of capital transfer complements, on a micro-level, the Bank's efforts to help countries implement broader-based structural reforms.

Support for the Debt Strategy

This is, I believe, a particularly opportune time for legislative action to support the activities of the Bank. In early April, I conferred with Finance Ministers and Central Bank Governors from around the world in meetings of the World Bank and IMF. I was greatly heartened by the broad support expressed for our proposals by the various groups -- the Group of Seven, the Group of Ten, and the Interim and Development Committees of the

IMF and World Bank. The IMF Interim Committee, for example, which represents the views of both debtor and creditor governments, welcomed the U.S. proposals to strengthen the debt strategy and "requested the Executive Board to consider as a matter of urgency the issues and actions involved." In particular, the Committee agreed that "the Fund should provide resources in appropriate amounts to members to facilitate debt reduction by setting aside a portion of members' purchases under Fund supported arrangements."

It is critical now that we build upon the momentum established by these meetings and take the steps necessary to implement the strengthened debt strategy. This involves ensuring that the international institutions which have been asked to take leading roles have adequate resources to do the job.

I hope that the United States will take the lead in this process, Mr. Chairman, by fully funding the World Bank and the other development institutions. The regional development banks will also play an important role in the strengthened debt strategy. The operations of the African, Asian, and Inter-American Development Banks complement and support the policy reforms promoted by the World Bank and the IMF. As the World Bank seeks to expand the array of sectoral and structural adjustments targeted by its lending, the regionally focused institutions can help reinforce the incentives for debtor countries to implement policies that will lead to sustainable growth and recovery.

In particular, we expect the Inter-American Development Bank, now that agreement has been reached on a capital increase, will undertake lending programs that encourage its borrowers to adopt policies that will contribute to their economic recovery.

ENVIRONMENT

Debt, however, is not the only major issue that needs U.S. leadership and the assistance of the MDBs. Global warming and other environmental matters are now of major international concern. The adverse effects of climate change and ozone depletion will not stop at national boundaries. These issues are global in nature and we must clearly develop new and cooperative ways to deal with them more effectively.

You, Mr. Chairman, and members of this committee have shown a great deal of leadership in galvanizing the MDBs to action on these matters, working closely with the Executive Branch. Congress, in fact, has given the Executive Branch a substantial mandate to promote a heightened environmental awareness in the MDBs and to assure that progress on this front is achieved in the developing countries. Important headway on various levels has been made over the past year and we are fully committed to doing

more in this important area. All of us are looking to these institutions to play a critical role in helping to keep this planet and our environment habitable.

Largely through U.S. efforts, the Development Committee Communique of April 4 noted that members stressed the increasing importance attached to environmental issues and to the timely dissemination of environmental information on Bank-supported operations. In addition, the Committee agreed to discuss at their next meeting the Bank's efforts to support the environment, including the integration of environmental concerns in Bank operations and measures to increase public awareness of World Bank environmental activities.

In order to continue to influence this effort, we must be prepared not only to insist on a critical examination of these issues, but also be willing to provide the needed financial support. To help convince you that such support is warranted, I would like to review some of the reforms now under way to strengthen the MDBs effectiveness in addressing environmental concerns.

Recent Reforms

The Inter-American Development Bank (IDB), as part of the recently negotiated replenishment agreement, is to establish an environmental line unit to assist in evaluating environmental aspects of projects early in the project cycle. It was the United States government that called publicly for the establishment of this unit, first at the Bank's Annual Meeting in Caracas in 1988, and again at this year's Annual Meeting in Amsterdam. The IDB has also held five environmental seminars for members of its technical staff and estimates that 80 percent of its operational staff has now completed the training.

The African Development Bank (AFDB) established its own environmental line unit in 1988. This unit is headed by a recently recruited African expert who is assisted by three experts seconded from industrial countries, including one from the United States seconded under the provisions of an AID technical assistance program. The African Development Bank is also working with the Sierra Club, the Natural Resources Defense Council, and the American Farmland Trust to set up a conference to increase cooperation between environmental agencies and non-governmental organizations (NGOs) in four of its borrowing countries. This initiative, which we encouraged at the AFDB's Annual Meeting in Abidjan last year, is not proceeding as rapidly as we had hoped. However, we look forward to the conference taking place in the second half of this year.

The World Bank renewed and strengthened its pledge to environmental reform in the Executive Directors Report on the

General Capital Increase that was negotiated in 1988. Language in the report, that was agreed among both developed and developing countries, called specifically for "better management of natural resources and for integration of environmental work into country development strategies, policies and programs; the evaluation of environmental costs of projects, and mitigation or elimination of adverse effects." Our job now is to see that this pledge is fulfilled. This year, the Bank almost doubled last year's administrative budget for environmental work, increasing it to $9.4 million in FY 1989 compared with $4.8 million in FY 1988. We are working to assure that a further increase dedicated to environmental work will be set aside for next year, particularly in the regional units which monitor the project appraisal process.

The Asian Development Bank (ADB) established an environmental line unit in 1987. The Bank is continuing to work on refining the participation of the unit in the project cycle. The role of this unit is set out in the Bank's initial paper on "Preliminary Environmental Screening of Loans and Technical Assistance Projects." In addition, the Bank has published other papers covering secondary screening procedures and provisions for participation of environmental specialists in loan and technical assistance appraisals. It is also focusing greater attention on environmental protection measures in loan agreements and in documents that give guidance to missions and to post-evaluation and review operations.

I have provided only a very brief summary of some of the progress we have made in the MDBs on environmental issues over the past year. More information is included in the Annual Report that we submitted to Congress earlier this year.

Tropical Forests

No environmental issue has engaged more public concern than the destruction of tropical rain forests. The U.S. Government is determined that the MDBs will adopt policies and procedures for protective measures in the appraisal of projects that may adversely affect these forests and other fragile eco-systems. We have taken several steps to increase international understanding of the importance of this issue and to build greater support for measures to protect all such eco-systems that may be threatened by development projects and programs.

In April of last year, Treasury released its own standards for U.S. evaluation of MDB projects affecting tropical moist forests. These standards, developed with support from more than 50 environmental groups in this country, were immediately made available to the management and staff of the World Bank and to the regional development banks. They were also tabled at an Ad Hoc meeting of environmental experts held under the auspices of

the Organization for Economic Cooperation and Development (OECD) in Paris last May. We have made arrangements to see that they will be discussed again at a follow-on meeting of the OECD's Development Assistance Committee that will be held in Paris in June.

Other Initiatives

We have also released U.S. standards for evaluating MDB projects adversely affecting wetlands and Sub-Saharan savannas and we are now working with the Natural Resources Defense Council and other environmental organizations to complete standards for protecting important marine areas such as coral reefs and seagrasses.

In addition, Treasury has set up an informal working group with Greenpeace to help us develop more effective measures to encourage integrated pest management. Another group is being organized to help us address energy efficiency and conservation issues. I am hopeful that we will have more progress to report in both of these important areas by the time of our next report.

Assessment of Environmental Impact

It is imperative that appropriate environmental impact assessment procedures be established within the MDBs and in borrowing countries. There is also a critical need for the MDBs to provide environmental information on projects to the public in advance of Board action. I stressed the importance of environmental issues at the Annual Meeting of the World Bank in Berlin last September. In March of this year, I wrote a letter to President Conable emphasizing the importance we attach to providing access to information and the need for the Bank to act more quickly in this area. Two weeks ago, we made a statement to the World Bank's Development Committee highlighting once more the importance of prompt action. I have urged my colleagues in other developed countries to support these efforts, and we will press hard in the months ahead to get international agreement on appropriate procedures.

We will be most effective if we can mobilize international support for environmental impact assessment procedures and access to information, and work with our colleagues from other countries, both developed and developing, in establishing procedures that are acceptable to all member countries. We need to focus our efforts on bringing about the changes that we think are important within the MDBs and in the countries that borrow from them.

We have reservations regarding legislation to extend National Environmental Policy Act (NEPA) procedures to U.S. votes in the banks. Extension of NEPA would move the focus of

our efforts away from reform of MDB procedures, which is the right focus, to internal U.S. Government procedures. We are also concerned that extension of NEPA could be viewed as a unilateral U.S. approach that would generate opposition to our proposals and hold back our efforts to promote reform. On the other hand, I would strongly support an initiative that seeks to develop appropriate procedures within the MDBs. Such procedures might well be based on other procedures already established in member countries or accepted by international organizations.

OTHER U.S. INTERESTS IN THE MDBs

I believe there is more than ample reason for the United States to support the MDBs based on the international debt and environmental considerations which I have just reviewed. However, since U.S. interests in these organizations cover many areas, as this Committee is well aware, let me quickly review other dimensions of U.S. interests in fostering a strong foundation for the multilateral development banks.

First, they support our geo-political and strategic interests. The MDBs lend to countries that are strategically important to the United States, such as Turkey, the Philippines, and Mexico. MDB involvement leads to further cooperation on a number of fronts, including controlling international migration, and promoting democracy and human rights.

Second, the MDBs advance the broad U.S. economic objective of promoting the growth of a free, open, and stable economic and financial system. They do this by encouraging and supporting developing country movement toward more open trade and capital flows, including greater reliance on the private sector and free-market pricing policies.

Third, the MDBs support U.S. objectives to improve the quality of life for impoverished people throughout the developing world. They provide, particularly through their soft loan windows, special funding for social programs and generally promote overall economic growth and productivity in developing countries.

Finally, stronger, more stable, growing developing country economies directly help the U.S. economy: they contribute to an expansion of employment in the United States through increased exports. Let me elaborate on this point to underscore just how important this is for the U.S. economy.

Agriculture

The agriculture sector illustrates this vividly. Six out of every ten people in developing countries depend on agriculture and related pursuits for their livelihood. Hence, the most

direct way to increase incomes in these countries is to assist agriculture. Indeed, the MDBs are a prime source of project finance and technical advice in this key sector. Overall, more MDB lending goes into the agriculture sector than any other -- roughly 25 percent annually.

In poorer countries, up to 60 percent of increased income is spent on food and upgrading the quality of the diet, and this virtually always translates into more animal protein in the diet. Production of more animal protein, in turn, requires more feed grains and soybean meal -- products that U.S. farmers produce more efficiently than anywhere else in the world. In fact, the output from one in four U.S. cropland acres enters export markets, creating nearly one million farm and off-farm jobs. Roughly 40 percent of U.S. agriculture exports is sold in developing countries. Hence, living standards in the Third World, where diets have ample room to grow, will probably play a greater role than any other factor in determining whether U.S. agriculture will stagnate or flourish.

South Korea's recent economic performance illustrates the potential for increased U.S. exports. Since 1982, per capita consumption of livestock products increased from 18 to 25 kilograms per year, a 39 percent increase which is very high compared to the relatively flat consumption patterns in the United States and Europe. The quantity of U.S. feed grains and soybean exports to Korea doubled in the period from 1980 to 1987. It is important to note in this connection that the MDBs played a key role in Korea's economic success: MDB loans to Korea have totaled over $8.7 billion.

Information Technology

A sector that is becoming increasingly pivotal to growth in all countries is information technology. Within a matter of decades, government and commerce in the industrialized world have become dependent on rapidly changing computer hardware and software, and the new forms of telecommunications -- satellite transmission and optic-fiber cables -- that link computers, telephone, and television. But information technology can also be invaluable in agricultural research, health services, and other traditional development activities. Proper utilization of these technologies can help economies run much more efficiently. Microelectronics, for instance, can help countries make better use of electric power, thus limiting capital costs; and computerization of financial and economic data increase their accuracy and utility for growth and development several fold.

The MDBs can play a critical role in helping developing countries gain access to information technology. Indeed, we believe that this is an area in which there is considerable scope for greater MDB activity, particularly the World Bank.

Not only is strengthening the information technology capability of developing countries in their self-interest, it is in our self-interest as well. A growing, more productive economy is a growing market for U.S. exports. But more directly, the U.S. is a world leader in this sector. As the developing countries grow and increase their purchases of information technology hardware and software, U.S. producers should be well poised to secure much of this business. In recent years U.S. exports of computers and business equipment to developing countries have jumped dramatically. Korea went from importing $161 million in 1984 to $489 million in 1988, a 300 percent increase; and Mexico increased from $338 million to $602 million, almost a 180 percent increase during a period when their ability to import has been sharply curtailed.

U.S. Business Contracts

In this context, it is useful to note that business contracts resulting from MDB projects are a direct and tangible benefit stemming from U.S. participation in the MDBs. These contracts are composed of three related elements. First, there is the procurement stemming directly from MDB-provided finance. U.S. businesses secured roughly $1.9 million in contracts from the MDBs last year. This compares with U.S. budget expenditures for the MDBs averaging about $1.3 million annually. Secondly, since the MDBs only provide a portion of the finance needed for a project, there are other procurement possibilities generated by non-MDB finance for a project.

Finally, the business contacts established through U.S. business participation in bidding on MDB projects leads to follow-on business. For instance, Morrison-Knudsen, a U.S. engineering and construction firm, and ECI International, a U.S. firm specializing in the supply of educational and vocational training equipment, have sent letters to Congress noting that contacts established on an MDB project are helpful in pursuing non-MDB opportunities. In sum, MDB projects are an important nexus for the development of U.S. exports.

To assist U.S. business in competing for MDB contracts, the Omnibus Trade Act required the appointment of commercial officers to serve with each of the U.S. Executive Directors at the MDBs. The Treasury Department is consulting with the representatives of the International Trade Administration and the Foreign and Commercial Service about these appointments. It is expected that the positions at the Asian and African Banks will be filled in the near future. In addition, Treasury is working with the MDBs to improve the quality and timeliness of information about contract awards on MDB projects.

Burden-sharing

Fortunately, the burden of financing the operations of these institutions is shared by all member countries. Consequently, U.S. interests in developing countries can be pursued through these institutions without the United States bearing the full burden. This is particularly important during periods of severe budgetary constraint.

We currently maintain a 34.5 percent share in the capital of the Inter-American Development Bank. Our shares in the other IFIs are much lower. In recent years the contributions of other donor countries -- including some developing countries -- to these institutions have increased relative to the United States as their respective economies have grown and prospered. This is particularly important for MDB concessional lending operations where all contributions are fully paid in.

For their market-related lending operations, the MDBs leverage the callable capital guarantees of member countries to borrow funds on private capital markets. Hence, the majority of MDB loans are financed with relatively small cash outlays from MDB members, and are cost-effective when compared with U.S. bilateral economic assistance.

In FY 1988 the United States provided $3.1 billion in foreign economic assistance (Development Assistance and the Economic Support Fund) to 75 countries, exclusive of Israel, Spain, and a few other higher income countries. These countries received U.S. assistance to engender close cooperation and enhance our national interest through increased political, economic, and military stability in the Third World. These same countries received additional commitments of $18 billion from the MDBs -- but at a cost to the United States of only $1.2 billion in budget authority. Hence, for about one-third the budget cost of all our bilateral aid programs, U.S. payments to the MDBs leverage lending programs that are almost six times as large as our bilateral programs.

In addition, the MDBs provide considerable finance and technical assistance to countries such as Argentina, Brazil, and Mexico that are of considerable geo-political importance to the United States -- but which receive virtually no U.S. economic assistance. The MDBs made commitments of over $5 billion to these countries in FY 1988.

ENHANCED STRUCTURAL ADJUSTMENT FACILITY (ESAF)

In addition to our requests for funding of the MDBs, the Administration is seeking authorization and appropriation in FY 1990 for a modest $150 million contribution to the Interest

Subsidy Account of the Enhanced Structural Adjustment Facility (ESAF) of the International Monetary Fund (IMF).

In recent years, the international community has adopted a comprehensive approach to help the poorest countries, particularly those in Sub-Saharan Africa, to implement the structural economic reforms which are essential for the increased growth and development necessary to alleviate poverty and improve basic human needs. This approach draws upon the collective efforts of the IMF, World Bank, and official creditors.

The ESAF represents the centerpiece of the Fund's efforts to address the plight of the poorest countries. It was established in 1987 to enable the IMF to provide financial assistance on concessional terms to the poorest countries experiencing protracted balance of payments problems and prepared to undertake multi-year economic reforms. It builds upon the IMF's Structural Adjustment Facility (SAF), which was established in 1986 in response to U.S. proposals to assist the low-income countries adopt growth-oriented reforms. The ESAF is expected to provide new resources totaling $8 billion to low-income countries engaged in economic and structural adjustment. These resources will supplement the roughly $2.5 billion remaining to be disbursed under the SAF.

The ESAF is catalyzing significant additional resources for the low income countries through its association with the Policy Framework Paper (PFP) process, a unique and historic step forward in strengthening collaboration between the Fund and World Bank. Under this process, the two institutions work in a mutually constructive manner in helping resolve the special problems in the poorest of the developing countries. Member countries eligible to use the SAF and ESAF develop a medium-term PFP -- a joint document of the Fund and Bank -- outlining their structural and macroeconomic reform efforts and containing an assessment of their financing needs, including possible IMF and World Bank financing. The Fund and Bank are now conducting joint staff missions to prepare the PFPs.

The World Bank agreed to earmark $3 to 3-1/2 billion of the Eighth Replenishment of the International Development Association (IDA) for adjustment programs related to PFPs. Substantial donor support is also being catalyzed through co-financing, in particular for Sub-Saharan Africa under the Bank's Special Program of Assistance. Furthermore, at the Toronto Summit, the Heads of State or Government agreed to ease the debt servicing burdens of the poorest countries undertaking internationally supported adjustment programs. The mechanisms to address these debt service burdens have been developed by the Paris Club, the institution responsible for rescheduling debt owed to official creditors, and are working smoothly.

The United States is the only major industrial country that has not yet contributed to the ESAF. The IMF is the central monetary pillar of U.S. international economic policy and a key policy instrument to advance our economic and security interests. A modest contribution to the ESAF would go far to maintain our credibility in the IMF and provide the United States with a voice on issues of central importance to our national interests and the well-being of the world economy. It would help many of the low-income countries to adopt necessary growth-oriented reforms. Many of these countries, including Pakistan, Bolivia, Zaire, and other key nations in Sub-Saharan Africa are of significant strategic importance to the United States.

Countries contributing to the ESAF are expected to provide loans of about $8 billion. The United States is one of the very few major member countries not providing loans. We have consistently indicated that we could not provide loans due to budget constraints, and we are not now proposing any U.S. loans to the ESAF. The necessary size of such loans would, in my view, be prohibitive.

We should, however, contribute modestly to an account which will help subsidize ESAF loans to developing countries. The proposal before you is to make a $150 million contribution to an Interest Subsidy Account of the ESAF which would make its loans concessional. It is critical that loans from the ESAF be provided on realistic terms to these low-income countries.

Budget authorization and appropriation of the full U.S. contribution is being sought in FY 1990 to provide the IMF with adequate assurance that resources will be available to finance the interest subsidy. However, actual disbursements from the U.S. contribution would occur over the period through U.S. FY 2001, roughly the final date for interest payments on ESAF loans. Consequently, actual budget outlays each year will be small and would not exceed $3 million in FY 1990, with the bulk of the outlays occurring in the latter part of the 12-year period.

Such a contribution would be particularly cost-effective. The U.S. contribution represents only one and one-half percent of the total resources being provided to the facility, in comparison with our IMF quota share of some 20 percent. Moreover, the amount of resources the ESAF can bring to bear in the poorest countries often far exceeds the amounts that can be mobilized through our bilateral assistance.

For these reasons, Mr. Chairman, I urge you to support enactment of legislation providing for a contribution by the United States of $150 million to the Interest Subsidy Account of the IMF's Enhanced Structural Adjustment Facility.

INTERNATIONAL FINANCE CORPORATION (IFC)

As you are aware, U.S. support for the IFC has come under question as a result of major shortfalls in our planned purchases of shares. In 1985, we agreed to a capital increase of $650 million for the IFC, but have been able to pay for only 34 percent of our allotted 175,162 shares (at $1,000 each). We are at a critical juncture, wherein we must pay our capital arrears to allow the IFC to pursue a number of private sector development activities. Otherwise, we risk a serious weakening of the institution's financial well-being and a loss of U.S. leadership in the institution.

The IFC is the arm of the World Bank that makes equity investments in and loans to private sector enterprises in the developing world. It operates without government guarantee -- thus reducing the role of governments in developing economies. More significantly, equity investment by the IFC, as well as loans, allows enterprises to grow without increasing their indebtedness. It has been an important catalyst of investment funds, most recently attracting $7.50 from other sources of capital for every $1 it lends and invests.

The IFC also plays an important role in advising governments about how to improve the environment for investment in their countries. It has contributed toward the development of capital markets through advice and investments. This work allows countries to generate financing from institutional and individual investors, both foreign and domestic, without the intermediation of commercial banks.

I would like to describe for you some of the most important initiatives under way at the IFC -- programs that require U.S. financial support for the institution to be carried out in full over time.

Sub-Saharan Africa

As part of an overall plan to increase IFC's involvement in Sub-Saharan Africa, the IFC has undertaken or participated in three related programs: the African Project Development Facility, the African Management Services Company, and the Africa Enterprise Fund.

The African Project Development Facility was established two years ago by the IFC with the African Development Bank and the UNDP. Teams based in Abidjan and Nairobi provide advice to companies planning investments and help them raise finance. Their work is complemented by the African Management Services Company (AMSC), which trains the personnel necessary to manage companies. The IFC invested in the AMSC in 1988, as a logical extension of its work in Sub-Saharan Africa. The AMSC provides

management training for new ventures, existing private companies, and parastatals undergoing privatization. The AMSC also provides back-up in areas such as marketing, product development, and improved productivity.

The IFC has rounded out its role in Sub-Saharan Africa with the establishment of the Africa Enterprise Fund (AEF) to promote IFC investment in small -- and medium-sized enterprises. A large number of IFC professionals have been sent into the field with authority to take decisions autonomously on much smaller investments than those IFC normally makes. Despite their small size -- ranging from $100,000 to $750,000 -- these investments are subjected to the same standards of analysis applied to larger investments. This extremely labor-intensive program meets the financing needs of small African entrepreneurs who would never be able to attract IFC investments without this type of outreach. As the profits on this activity are much lower than those from larger investments, the IFC's ability to continue the program will be limited if U.S. funding shortfalls are not paid.

Private Sector Development

Among other efforts to support development of the private sector, the IFC pursues three main activities in capital markets development: advising in the establishment and/or strengthening of capital markets; investing or lending to domestic capital market institutions in need of support; and improving the access of companies and financial institutions to the global financial markets.

We expect these efforts to pay substantial dividends over the coming years. The most important effect will be lowering the need for borrowing to finance investment. Other positive effects will be liberalization of financial systems, opening of companies to public control, and reduction of the role of governments in capital investment.

The IFC's Corporate Finance unit has pursued corporate restructurings through a three-phase approach. It conducts an intense review of a company's finances and operations, followed by the use of various techniques to achieve the optimum use of the firm's internal resources. Companies may engage in debt buy-backs, debt-equity conversions, or debt swaps and/or exchanges. Finally, the IFC, the company, and its creditors negotiate an agreement on the restructuring, which usually involves an investment by the IFC. These negotiations are settled on a case-by-case basis, using a market-oriented approach.

Since 1985, the IFC has participated in about 50 corporate restructurings, one half of which have been in Latin America and the Caribbean. This type of fee-generating service is being increasingly provided by the IFC in its role as an "investment

bank for development." While this service is self-financing, it does not generate the kind of profits that the IFC needs to finance its growing investments.

INTER-AMERICAN DEVELOPMENT BANK (IDB)

As you are aware, Mr. Chairman, member countries of the Inter-American Development Bank (IDB) have agreed to increase the Bank's capital and replenish the resources of the concessional window, the Fund for Special Operations (FSO). Final agreement was reached during the Bank's annual meeting in March. It calls for a $26.5 billion capital increase and a $200 million replenishment of the FSO. The annual U.S. share of the subscriptions to paid-in capital and contributions to the FSO would be $77.9 million.

The agreement is a good and fair one that reflects the needs and desires of both the donor and borrowing member countries. The result will be a strengthened IDB that can more effectively support the growth and development of Latin America and the Caribbean. Under the agreement and with the organizational and procedural reforms that are already under way in the Bank, the IDB will:

- lend $22.5 billion over the 1990 - 1993 period;
- continue to seek ways to ensure that half of its lending program benefits lower income groups;
- provide up to $5.6 billion of fast-disbursing, policy-based sector lending;
- strengthen the country programming process to ensure that all its lending will support policy reform and self-sustaining growth;
- adopt a loan approval mechanism that allows greater weight to be given to the views of donor countries; and
- reorganize operating departments to implement sector lending and country programming, and to improve the overall efficiency of Bank operations. This will include enhancing its environmental analysis by establishing an environmental line unit.

With the replenishment now agreed and the organizational and procedural reforms being implemented, the Bank will also be able to make its contribution to helping resolve Latin America's debt problems. That contribution will be to encourage its borrowers to adopt policies that improve economic performance,

stimulate new foreign investment, increase domestic savings, and encourage the repatriation of flight capital. Private sector initiatives and the development of market-based economies should be emphasized. It will be critical, therefore, that the United States meet its funding obligations to the IDB in order that this process can be fully implemented.

CONCLUSION

In conclusion, Mr. Chairman, I want to emphasize the Administration's commitment to, and full support for, the MDBs and U.S. participation in the IMF Enhanced Structural Adjustment Facility. These institutions are vital to our efforts to strengthen the international debt strategy. It is critical that we provide full funding for U.S. participation in order to maintain U.S. leadership on debt issues, and to ensure that the strengthened strategy is implemented.

These institutions also serve the United States in a variety of other ways. We rely on the MDBs to promote policies which protect the delicate global environment that we all share. We depend on their role to promote our security and humanitarian interests.

Furthermore, the fate of MDB activities is important to the U.S. economy, since success in promoting sustainable growth will increase effective demand among developing countries for U.S. exports and reduce the strains on the international financial system. I also believe that successful operation of overall MDB programs will make one additional contribution: the promotion of peace and democracy among nations. I cannot overemphasize the importance I attach to this.

I recognize fully that, even in the best of circumstances, supporting foreign assistance is never popular. Now, at a time of severe budget constraint, it will be even more difficult. It is imperative that we support these institutions in their important tasks.

ANNEX

Fiscal Year 1990 Budget Request

We are requesting $1.6 billion for the MDBs and $150 million for the IMF's Enhanced Structural Adjustment Facility (ESAF) in FY 1990. These funding requests reflect both the need for budgetary restraint and the financial requirements for effective development programs. Our MDB request is comprised of MDB funding requirements currently due for payment, $1.3 billion, and $314 million of the $414 million in U.S. funding shortfalls to the MDBs. The stringency of the budget constraint on international affairs funding prevents the Administration from requesting the entirety of U.S. funding shortfalls on earlier scheduled MDB payments. These requests are composed exclusively of funding commitments negotiated by the Administration in close consultation with this Committee.

International Bank for Reconstruction and Development (IBRD)

For the IBRD (also known as the World Bank) in fiscal year 1989, the Administration is requesting: 1) $20.1 million in budget authority to complete the first installment to the 1988 GCI; and 2) $70.1 million in budget authority and $2,241.8 million under program limitations for subscription for the second installment.

The Bank's principal role today is making long-term credit available for productive projects, which will lead to economic and social development in its less developed members. These loans carry market interest rates. In addition to project finance, the IBRD provides policy advice and technical assistance and financing in support of structural reform, and serves as a financial catalyst and institution builder.

International Development Association (IDA)

For fiscal year 1990, the Administration is requesting: 1) $6.7 million to complete the second installment, and 2) $958.3 for the third and final installment for the $2,875 million U.S. share of IDA-8. IDA, an affiliate of the World Bank, is the single largest source of multilateral development assistance for lending on concessional repayment terms to the world's poorest countries. Over 96 percent of IDA lending goes to countries with an annual per capita income of $400 or less.

International Finance Corporation (IFC)

For fiscal year 1990, the Administration is requesting: 1) $79.9 million to fund the U.S. shortfalls in its subscription to the $650 million IFC capital increase; and 2) $35.0 million for the fifth and final installment. The IFC provides risk

capital as well as long-term loans; plays an important role as a catalyst in attracting private capital; and provides technical assistance to developing countries that want to encourage domestic and foreign private investment.

Inter-American Development Bank (IDB)

For fiscal year 1990, the Administration is requesting $31.6 million in budget authority to complete the U.S. commitment to the sixth IDB capital increase.

Fund for Special Operations (FSO)

For fiscal year 1990, the Administration is requesting $63.7 million in budget authority to complete the U.S. commitment to the sixth increase in FSO resources. These funds are required for the 1989 FSO lending program.

Inter-American Investment Corporation (IIC)

For fiscal year 1990, the Administration is requesting $25.5 million in U.S. funding shortfalls to the IIC. These funds, for the third and fourth of four installments to the IIC, would complete the U.S. commitment to this institution. The IIC is linked to the IDB, and is designed to support private sector activities in Latin America through equity and loan investments that focus primarily on small- and medium-scale enterprises.

Asian Development Bank (ADB)

The ADB is currently making lending commitments on the basis of capital stock that is fully subscribed by Bank member countries, including the United States. Hence, there is no need to request funding for the ADB in fiscal year 1990. The Bank makes loans at market rates to developing member countries in regions of key importance to U.S. strategic and economic interests.

Asian Development Fund (ADF)

For fiscal year 1990, the Administration is requesting: 1) $84.6 million in U.S. funding shortfalls to the first and second installments to the fourth replenishment of ADF resources; and 2) $146.1 million for the third, regularly scheduled installment. The stringent budget constraint on funding for international affairs prevents us from requesting the remaining funding shortfall of $100 million to the ADF until FY 1991. However, because of exchange rate changes and lower-than-expected lending levels, it is expected that the total $230.7 million requested will be sufficient to complete its project lending programs in calendar year 1989.

The ADF is a source of concessional finance to the poorest member countries of the ADB. Pakistan, Bangladesh, Sri Lanka, and Nepal are the major borrowers from the Fund.

African Development Bank (AFDB)

For fiscal year 1990, the Administration is requesting: 1) $1.6 million in budget authority to subscribe to paid-in capital to complete the second of five installments to increase the Bank's capital base; and 2) $9.0 million in budget authority and $134.8 million under program limitations for the third U.S. installment. The Bank makes loans on market terms for the economic and social development of fifty African member countries, individually and through regional cooperation. The AFDB is an important part of the U.S. commitment to work with the countries of Africa for the achievement of their long-term development objectives.

African Development Fund (AFDF)

For fiscal year 1990, the Administration is seeking $105 million in budget authority for the second of three installments of the U.S. contribution to the fifth replenishment of AFDF resources. The Fund complements AFDB operations by providing concessional financing for high priority development projects in the poorest African countries. The United States has a strong humanitarian interest in aiding the poorest countries of the world's least developed continent through its support for the AFDF.

IMF Enhanced Structural Adjustment Facility (ESAF)

For fiscal year 1990, the Administration is requesting $150 million in budget authority for a one-time U.S. contribution to the Interest Subsidy Account of the ESAF. The ESAF provides financial assistance on concessional terms to the poorest countries experiencing protracted balance of payments problems.

TREASURY NEWS

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STATEMENT OF
MR. DAVID M. NUMMY
ACTING ASSISTANT SECRETARY OF THE TREASURY FOR MANAGEMENT
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS

APRIL 17, 1989

Mr. Chairman, thank you for the opportunity to appear today to provide the Treasury Department's perspective of accounting and internal control system issues within the U.S. Customs Service. With me today are Mr. Samuel T. Mok, the Department's Comptroller, and Mr. Michael T. Smokovich, Assistant Commissioner for Federal Finance at the Financial Management Service. The Department's philosophy in general is to delegate operational authority commensurate with responsibility to its bureaus. The Department monitors performance and provides support and assistance where appropriate. In the case of Customs, we are actively involved in assisting Customs in its efforts. Resolving the problems we are discussing here today is receiving a high priority from the Department.

Background

The Customs Service has been experiencing continuing problems with the ability of its financial management systems to produce complete, accurate, and timely data. In our 1986, 1987, and 1988 Federal Managers' Financial Integrity Act (FMFIA) Reports to the President and Congress, the Department was able to provide assurance that all of Treasury's systems of accounting and internal control conform to the standards prescribed by the Comptroller General except those of the U.S. Customs Service. At the present time, Customs' systems contain problems in the areas of:

- general data integrity,
- the ability to produce accurate and reconcilable external and internal reports,
- reconciliation between general ledger and subsidiary accounts, and
- discrepancies between reported collections and deposits.

Departmental Response

The Department has taken several steps to help Customs' remedy the problems identified as a result of the FMFIA review process. In October 1987, the Assistant Secretary (Management) furnished

(over)

Customs with an action plan to correct known problems and identify any additional deficiencies. In response, Customs developed its own comprehensive plan to correct systems weaknesses. Customs' plan included the procurement of contractor support for a complete review of its financial systems, which was approved by the Department in January 1988. The contractor's final report was issued in October 1988, and confirmed many existing problems in addition to identifying several new issues.

Concurrent with the contractor's systems review, a Departmental team was formed to perform a study of Customs' financial management structure and practices. The study team's report was completed in September 1988, and contained a variety of recommendations for improving the financial management organization and practices of the Customs Service. Customs' has generally implemented those recommendations which could be accomplished in the near term, and is still in the process of addressing the more complex issues requiring a more protracted time period to complete. The subcommittee has previously been furnished copies of the contractor's review and the Department's study.

Ongoing Efforts

Customs has recently formed an internal task force to direct and coordinate the correction of all known financial systems deficiencies. The task force reports to Customs' Deputy Commissioner. On a continuous basis my office reviews Customs' plans, identifies issues that merit attention, and encourages prompt corrective actions in order to provide the necessary guidance and support to resolve the financial system problems. As part of that evaluation, we conduct periodic progress reviews with Customs' senior financial management officials. Finally, the Deputy Commissioner and I meet monthly to discuss the progress being made.

Assessment

We are encouraged by the direct involvement of Customs' Deputy Commissioner in the FMFIA corrective action process, as this indicates a commitment by Customs' top management to resolve Customs' financial management problems. We believe Customs is now taking a reasonable approach toward correcting its accounting and internal control problems, and are optimistic that current initiatives will yield true results.

I will now be happy to respond to any questions you might have.

NATIONAL ADVISORY COUNCIL

ON

INTERNATIONAL MONETARY AND

FINANCIAL POLICIES

SPECIAL REPORT

TO THE PRESIDENT

AND TO THE CONGRESS

ON A PROPOSED U.S. CONTRIBUTION

TO THE

ENHANCED STRUCTURAL ADJUSTMENT FACILITY

OF THE INTERNATIONAL MONETARY FUND

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April 1989

I. Introduction

The National Advisory Council recommends to the President and to the Congress the enactment of legislation providing for a contribution by the United States of $150 million to the Enhanced Structural Adjustment Facility (ESAF) of the International Monetary Fund (IMF). The ESAF was established in 1987 to enable the IMF to provide financial assistance on concessional terms to the poorest developing countries experiencing protracted balance of payments problems and prepared to undertake multi-year economic reform programs. It is an integral part of concerted international efforts to help the poorest countries, particularly those in Sub-Saharan Africa, to implement the structural economic reforms which are essential for the increased growth and development necessary to alleviate pervasive poverty and improve basic human needs.

The U.S. contribution would take the form of a payment to the interest subsidy account of the ESAF for use in reducing the interest charges on ESAF loans to the concessional levels more appropriate to the financial situation and capabilities of the poorest countries. Such a contribution is essential to assure that the United States has an effective voice in ESAF activities and that the more than SDR 8 billion in resources available from the facility will be used in a manner supportive of U.S. economic and national security interests.

This report describes the economic situation in the ESAF-eligible countries and the need for the ESAF; reviews the role of the IMF in the poorest countries; provides a detailed description of the ESAF provisions; and describes the legislation proposed to give effect to the U.S. contribution.

II. The Economic Situation in the Poorest Developing Countries

During the current decade, the economic performance of the ESAF-eligible countries (excluding China and India) has lagged substantially behind that of the developing countries as a whole. (See Table 1.)

The ESAF-eligible countries (generally those having per capita income of $410 or less in 1980) have confronted many of the same difficulties as the middle-income debtors. For example, they were affected by the global recession in the early 1980s, rising interest rates and difficulties in sustaining domestic policy reforms. These problems were all the more acute because, like the middle-income debtors, many of these countries had overborrowed during the 1970s and used these resources to finance consumption at the expense of investment.

The plight of the ESAF-eligible countries was aggravated, however, by even sharper terms of trade losses than the developing countries as a whole, reflecting the heavy dependence of these countries on raw material exports and the sharp fall in global commodity prices. For example, between 1980 and 1988, terms of trade declined on average by 1.6 percent per annum in the ESAF-eligible countries (3.0 percent per annum in Sub-Saharan Africa) whereas they were nearly unchanged on this basis for all developing nations. As a result, the economic situation in these countries remains highly precarious and these nations have been unable to effectively address widespread poverty and the basic human needs of their populations.

The ESAF-eligible countries suffered declines in per capita income of roughly 0.5 percent per year during 1981-1983, and their overall per capita income growth over the entire period 1980-88 averaged only half a percent a year. This poor performance represented a significant setback, especially in view of the already weak and fragile economic situation of these countries at the beginning of the decade.

The weak economic performance of these countries was mirrored as well in their external accounts. These countries experienced substantial import compression throughout most of this decade, with nominal imports falling more than 10 percent between 1980 and 1983. Nominal imports did not reach 1980 levels again until 1987 and even by 1988, imports were substantially below 1980 levels in real terms. As a result of this poor performance, investment was squeezed, impeding the low-income countries from developing their infrastructures and developing productive capabilities that would strengthen growth.

The external financial situation of these countries remains fragile and their financial outlook is precarious. External reserve levels, after falling in the mid-1980s, have been rebuilt somewhat but still represent less than 2 months' worth of imports. External debt levels are relatively heavy, in excess of 400 percent of exports, roughly three times the level for the entire group of developing countries. While much of this debt is owed to official creditors, the debt service ratio for this group remains relatively high, 28.4 percent in 1988 versus an average for all developing countries of less than 20 percent.

Within the group of low-income countries, the performance of the Sub-Saharan African countries was even weaker than that of the low-income countries as a whole. Economic growth for the Sub-Saharan African countries (excluding Nigeria) averaged only 2.3 percent per year over the period 1980-88, equivalent to negative per capita growth of roughly 0.5 percent per year. The consequences of this economic retrogression are all the more dramatic when account is taken of the extremely low economic base from which Sub-Saharan Africa started at the beginning of the decade. In effect, most Sub-Saharan African countries lost ground, both relatively and absolutely, throughout the 1980s.

Furthermore, though the total external debt of the Sub-Saharan African countries is relatively modest -- less than $100 billion if Nigeria is excluded -- in comparison with the major middle-income debtors, it is extremely large in relation to the size of their economies. For example, the debt to export ratio for the group of Sub-Saharan African countries, exclusive of Nigeria, is over 300 percent, roughly twice the relative burden for all developing countries. Furthermore, the current debt service ratio for the Sub-Saharan African countries represents roughly a 50-percent increase over the level which prevailed earlier in the decade. As a result, Sub-Saharan Africa's debt looms large and many of these countries have experienced debt servicing problems in the 1980s.

III. The Role of the IMF in the Low-Income Countries

The IMF has played a leading role in the past years in supporting the adjustment efforts and addressing the balance of payments difficulties of the low-income countries. Since the mid-1970s, the IMF has extended some SDR 13 billion under formal IMF programs and other facilities, including trust arrangements.

The bulk of these financial resources (SDR 11 billion) were provided in association with formal IMF arrangements, principally, standby programs. Consistent with the Fund's mandate as a monetary institution, these resources were generally extended with 3 to 7 year maturities on highly conditional terms carrying market-oriented interest rates. The adjustment programs supported by this financing emphasized fiscal and credit measures, aimed at reining in aggregate demand to a level consistent with the availability of resources, as well as reforms to achieve more appropriate relative prices, including greater market-orientation of exchange rates, so as to reallocate resources toward investment and exports.

The IMF long ago recognized that the situation in the poorest countries required special attention. However, the IMF's principle of uniform treatment constrained the Fund's ability to adapt its traditional approach to address the needs of the poorest. Therefore, the Fund has relied on its legal authority to act as a trustee to provide special assistance and concessional financing. Under Article V, Section 2(b), of the IMF's Articles of Agreement, the Fund is empowered, if requested, to "perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund." The operations involved in the performance of such financial services cannot be on the account of the Fund, nor can these services impose any obligation on a member without its consent. This provision affords the requisite scope and flexibility to the Fund to extend financial and technical assistance to its member countries. This authority has proven particularly useful in enabling the creation of mechanisms to reduce the cost of financing and alter the conditionality for low-income countries under the Fund's traditional arrangements.

- In 1976, the IMF created the Trust Fund to provide concessional balance of payments assistance (SDR 2.9 billion) to eligible developing countries as a supplement to assistance available from regular IMF facilities. The Trust Fund's resources were derived from the profits from the sale by public auction of a portion of the Fund's gold, supplemented by transfers by some of the beneficiaries of direct distributions of gold sale profits and income from investment of assets. Eligibility was defined in terms of per capita income (under SDR 300 from mid-1976 through mid-78, and under $520 from mid-1978 to mid-80). In addition, eligible countries were required to demonstrate a balance of payments need and make reasonable efforts to improve their balance of payments position. The Trust Fund was terminated as of April 30, 1981.

- The Fund established a Supplementary Financing Facility Subsidy Account in December 1980 to reduce the cost for low-income countries of using the Supplementary Financing Facility (SFF). The SFF, financed by borrowings from member governments, made resources available to countries requiring financing in excess of amounts available under upper credit tranche programs. The subsidy account was financed primarily from repayments of and interest on a portion of the Trust Fund loans (up to SDR 750 million).

- In 1986, the IMF created the Structural Adjustment Facility (SAF) to promote comprehensive growth-oriented reforms in the poorest countries facing protracted balance of payments problems, using the $2.7 billion in reflows to the Trust Fund. This facility was established in response to U.S. proposals, presented at the 1985 IMF/World Bank Annual Meetings in Seoul, Korea. (The SAF is discussed at length below.)

As discussed in the previous section, many of the low-income countries at times faced an adverse external environment in the late 1970s and 1980s and encountered difficulties in sustaining domestic policy reforms. Against this background, the IMF's efforts to meet the adjustment and financing needs of the low-income countries through formal IMF arrangements at market related interest rates and with relatively short maturities, particularly for countries in Sub-Saharan Africa, contributed to many instances of prolonged use of the Fund's limited resources and growing arrears on its obligations. For example, of the 39 members with four or more IMF programs over the last 10 years, 22 were low-income countries. Also, of the Fund's SDR 2.4 billion of arrears with maturities of 6 months or longer at the end of 1988, roughly 80 percent are accounted for by low-income members. Prolonged use of IMF resources and arrears are threatening to undermine the IMF's ability to fulfill its responsibilities to deal with the problems of the major debtor developing countries as well as the financial integrity of the Fund.

Widespread recognition has emerged that the large IMF role in the low-income countries, emphasizing traditional adjustment programs which rely on shorter-term financing at market-related rates of interest, might not be either appropriate or desirable. In view of these difficulties, an effective response to the balance of payments financing and economic problems of the poorest countries requires a comprehensive strategy involving:

- o Longer term reforms to remove macroeconomic and structural impediments to growth.
- o Concessional financing, consistent with the ability of the poorest countries to sustain growth and meet repayment obligations; and
- o Intensified collaboration between the IMF, World Bank and international donor community to mobilize resources in support of adjustment efforts.

Many of the economic and balance of payments problems of the poorest countries reflect deep-seated impediments to an efficient allocation of resources, appropriate production incentives, and the mobilization of domestic savings. These problems must be tackled by the adoption of comprehensive macroeconomic and structural reforms in order to establish a foundation for sustained growth. Structural measures should increase the market orientation of an economy and thus improve the efficiency of resource allocation. Such measures include:

- o A greater focus on market-determined prices, by allowing exchange rates to reflect supply and demand for foreign exchange, removing subsidies, and liberalizing pricing regimes;
- o Tax reform to increase incentives to work, save, and invest, and financial market reforms to provide for more efficient allocation of savings;
- o Privatization of governmental entities;
- o Improving efficiency through greater competition and deregulation; and
- o The liberalization of trade and foreign direct investment practices to open the economy and provide access to foreign goods, technology, and capital.

As part of this strategy, it was also recognized that the poorest countries would require more financing than could be provided by the SAF and traditional Fund arrangements and on concessional terms consistent with the ability of these countries to meet repayment obligations.

Against this background, IMF Managing Director Michel Camdessus proposed at the 1987 Venice Summit a substantial enhancement of the resources available under the SAF. The Summit countries welcomed the Manager Director's proposal and in late 1987, the IMF established the Enhanced Structural Adjustment Facility (ESAF), with the objective of obtaining additional loanable resources of some SDR 6 billion derived from national contributions.

The ESAF represents the centerpiece of the Fund's efforts to address the plight of the poorest countries. However, the structural economic problems and protracted balance of payments difficulties facing the poorest countries will also require a coordinated effort with the World Bank, with its financial resources and expertise in structural and sectorial areas, and bilateral donors.

As such, the ESAF was also envisaged as playing a catalytic role as part of an expanded international effort to help the poorest countries. To this end, the ESAF builds on the intensified IMF and World Bank collaboration that had been developed under the SAF through the establishment of the Policy Framework Paper (PFP) process.

The PFP process represents a unique and historic step forward in promoting intensified collaboration between the World Bank and IMF in the low-income countries. Through the PFP process, Fund and Bank staff are conducting joint missions and working more closely together to ensure that the low-income countries receive consistent policy advice. Under this process, member countries eligible to use the SAF and ESAF develop a medium-term PFP, in cooperation with the IMF and World Bank, outlining a 3-year adjustment program including structural measures and delineating in broad terms the expected path of macroeconomic policies. The PFP also contains an assessment of the social impact of the proposed policy measures as well as of the country's financing needs and possible sources of financing, including those from the IMF and World Bank.

The PFP process is having the desired catalytic effect in support of growth-oriented reforms. In addition to the amounts committed by the Fund, the World Bank, for its part, agreed to earmark $3 to 3 1/2 billion of the $12.4 billion of the Eighth Replenishment of the International Development Association (IDA) for adjustment programs related to PFPs. Furthermore, the Bank has extended over the 1986-88 period, $3.9 billion in adjustment lending to the 30 countries with PFPs. Substantial donor support is also being catalyzed through co-financing, in particular for Sub-Saharan Africa under the Special Program of Assistance. Donor co-financing for IBRD Fiscal Years 1988-90 in Sub-Saharan Africa is projected to total $12.5 billion under IDA and IBRD operations.

Furthermore, at the 1988 Toronto Summit, the Heads of State or Government agreed to ease the debt servicing burdens of the poorest countries undertaking internationally supported adjustment programs. Subsequently, the Paris Club of official creditors established a framework of comparability, under which concessional

debt will be rescheduled at concessional interest rates over 25 years, including 14 years' grace. On non-concessional debt, creditors may choose from several options to reduce the debt service burden: (1) write-off one-third of debt service due, with the remainder rescheduled over 14 years with 8 years' grace; (2) interest rates to be reduced by 3.5 percentage points, or by half if the original rate is less than 7 percent, with repayment taking place over 14 years with 8 years' grace; and (3) rescheduling at market-based rates over 25 years with 14 years' grace.

IV. Description of the ESAF

The ESAF was established on December 29, 1987, as a separate IMF administered trust, whose objectives and basic procedures parallel those of the SAF. The ESAF is expected to provide resources totaling SDR 6 billion to low-income countries engaged in economic and structural adjustment. These resources will supplement the SDR 2.2 billion that remain to be disbursed under the SAF. The principal features of the ESAF are described below.

Eligibility

The low-income countries eligible for SAF/ESAF programs are the 62 members that qualify for loans from the International Development Association. The two largest eligible countries, however, China and India, have indicated that they do not intend to avail themselves of the resources of the facility, thus enlarging the amounts of financing available to other eligible countries. The majority of the eligible countries are in Sub-Saharan Africa. (Eligible members are listed in Table 2.)

Financing

The ESAF is expected to provide new resources totaling SDR 6 billion ($8.1 billion at end-December, 1988, exchange rates) to the low-income countries, in addition to the SDR 2.2 billion of financing remaining to be disbursed under the SAF. Thus, SDR 8.2 billion ($11.1 billion) of concessional resources are available to assist the poorest.

The resources for the ESAF are being provided by a group composed of almost all major industrial countries as well as some developing countries. In general, these countries are providing loans to a special IMF trust, supplemented by contributions to an interest subsidy account to enable the trust to extend financing at the desired concessional interest rate of 0.5 percent per annum. In some cases, however, the contributors are extending the loans directly at concessional rates and in a few others, countries are providing their contributions as grants to the interest subsidy account. As of December 31, 1988, loans to the trust totalled around SDR 5.3 billion, and contributions to the interest subsidy account were SDR 2.2 billion. (See Table 3.) Some industrial countries have indicated they would be prepared to provide additional loans if further resource commitments could be found.

National contributors are bearing the risks associated with their loans to the ESAF. The IMF has taken important steps, however, to protect ESAF creditors by improving the security and liquidity of their contributions to the ESAF. As part of the ESAF, the IMF established a reserve account in an amount of some SDR 4-1/2 billion, to be funded primarily from principal and interest payments on SAF loans supplemented, inter alia, by income from investing SAF resources.

Access/Maturities

Access under the ESAF will be determined for individual countries on a case-by-case basis with respect to their balance of payments needs and the strength of their adjustment efforts. Total access on average is intended to be around 150 percent of quota over the 3-year period of the ESAF programs, and maximum access is 250 percent of quota. This ceiling may be extended in exceptional circumstance up to a maximum of 350 percent of quota. In contrast, under the SAF, an eligible member could draw up to 63.5 percent of its quota over a 3-year period.

SAF disbursements are extended at an interest rate of 0.5 percent and this is the desired concessional interest rate for ESAF loans. Repayments of both SAF and ESAF loans are to take place in ten equal seminannual installments beginning 5-1/2 years and ending 10 years from the date of disbursement. In contrast, under IMF stand-by programs using ordinary resources, repayments are made in eight quarterly installments beginning 3 years and ending 5 years from the date of disbursement; these loans currently carry an interest rate of over 7 percent.

It was originally envisaged that commitments under the ESAF were to be made until November 30, 1989; final disbursements were to occur before June 30, 1992; and final loan repayments were to take place in the year 2002. This timetable is being extended by the Fund, by one year at a minimum, such that commitments will be made at least through 1990.

Monitoring Arrangements

Under the ESAF:

- o Quarterly quantitative benchmarks are established for the key financial variables normally covered by the annual arrangements;
- o A limited number of seminannual performance criteria will be used, including some structural reforms, domestic bank credit and fiscal targets and where appropriate, a balance of payments test and external borrowing criteria;
- o Mid-year reviews will generally be conducted on the basis of the benchmarks and performance criteria; and

- Prior actions will be required in a number of cases.

These monitoring arrangements provide considerably more flexibility than traditional performance criteria under regular IMF programs. For example, traditional IMF programs usually contain quarterly performance criteria oriented toward shorter term goals such as maintaining tight control over budgetary and credit indicators in order to reduce excess demand to a level consistent with resource availability as well as establish more appropriate exchange rates. In contrast with the ESAF, these monitoring arrangements do not focus as heavily on structural performance objectives and address the longer term obstacles to growth.

Operations to Date

As of the end of 1988, 30 SAF and ESAF arrangements were in place. (See Table 4.)

- There were 23 SAF arrangements with total commitments of SDR 1.1 billion and disbursements of SDR 0.6 billion.

- Six ESAF arrangements had been arranged with commitments totaling SDR 0.8 billion. Four of these six had been approved in November and December of 1988 alone. It is expected that a large number of ESAF arrangements will be approved in 1989, particularly as the November 1989, commitment date approaches.

- Of the 29 arrangements, 23 were with Sub-Saharan African countries.

V. A U.S. Contribution to the ESAF

The Administration is seeking authorization and appropriation in FY 1990 for a modest $150 million contribution to the Interest Subsidy Account of the ESAF. Such a contribution would strongly support achievement of U.S. foreign economic policy and security interests.

The ESAF is a central and critical element of international efforts to address the serious economic problems confronting the poorest countries. Among the poorest countries are a number of nations of significant strategic importance to the United States, including Pakistan, Bolivia, Zaire, and other key Sub-Saharan African nations. Moreover, the ESAF can play a pivotal role in addressing the significant problems of prolonged use of IMF resources, Fund arrears, and in strengthening collaboration between the Fund, World Bank and international donor community by building on the PFP process.

The United States is the only major industrial country that has not yet contributed to the ESAF. The Fund is the central monetary pillar of U.S. international economic policy and a key policy instrument to advance our economic and security interests. A modest contribution to the ESAF would go far to maintain our credibility in the IMF and provide the United States with a voice on issues of central importance to our national interests and the well-being of the world economy.

The proposed U.S. contribution would take the form of a payment to the Interest Subsidy Account of the ESAF for the purpose of helping to reduce the interest rate on ESAF loans to the desired concessional interest rate of 1/2 of 1 percent. Budget authorization and appropriation for the full U.S. contribution of $150 million are being sought in FY 1990 to provide the IMF with adequate assurance that resources will be available to finance the interest subsidy. However, actual disbursements from the U.S. contribution would occur over the period through U.S. fiscal year 2001, roughly the final date for interest payments on ESAF loans. Consequently, actual budget outlays each year will be small and would not exceed $3 million in FY 1990, with the bulk of the outlays occurring in the latter part of the 12-year period. (See Table 5.)

Even with an Interest Subsidy Account contribution, the United States would be one of the very few major countries not making loans to the ESAF trust -- the major part of the ESAF. The United States has steadfastly indicated it could not makes loans to the ESAF due to budgetary constraints.

A contribution to the Interest Subsidy Account would be extremely cost-effective. The U.S. contribution represents only some 1.6 percent of the total resources being provided to the facility, in comparison with our IMF quota share of some 20 percent. Moreover, the amount of resources the ESAF can bring to bear in the poorest countries is far in excess of the amounts that can be mobilized through our bilateral assistance. For example, in contrast with the SDR 8.2 ($11.1) billion of concessional resources available for lending under the ESAF, U.S. authorizations in FY 1988 for economic support, food and development assistance totaled only $0.9 billion for Sub-Saharan Africa and around $1.4 billion for the ESAF-eligible countries.

For these reasons, the National Advisory Council recommends to the President and the Congress the enactment of legislation providing for a contribution by the United States of $150 million to the Interest Subsidy Account of the IMF's Enhanced Structural Adjustment Facility.

Table 1

ECONOMIC INDICATORS
(in percentage terms)

Real Growth

	1983	1984	1985	1986	1987	1988
Small, Low Income Countries	1.6	3.3	3.7	4.4	3.6	4.9
Sub-Saharan Africa (exclusive of Nigeria)	-0.6	1.2	3.0	3.6	2.3	3.7

Real Growth Per Capita

	1983	1984	1985	1986	1987	1988
Small, Low Income Countries	-1.1	0.8	1.4	1.5	0.8	2.2
Sub-Saharan Africa (exclusive of Nigeria)	-3.6	-1.5	0.3	0.6	-0.6	0.7

Debt/Exports

	1983	1984	1985	1986	1987	1988
All Developing Countries	133	133	150	169	159	146
Small, Low Income Countries	338	344	404	422	456	437
Sub-Saharan Africa (exclusive of Nigeria)	230	228	274	303	331	325

Debt/GDP

	1983	1984	1985	1986	1987	1988
All Developing Countries	33	34	37	38	39	37
Small, Low Income Countries	45	45	52	52	60	61
Sub-Saharan Africa (exclusive of Nigeria)	52	55	62	63	70	68

N.B. The group of small, low-income countries is essentially equivalent to the group of ESAF countries.

TABLE 2

Low-Income Developing Members Eligible for Assistance Under the Enhanced Structural Adjustment Facility

Member	Quota (in SDR millions)	Member	Quota (in SDR millions)
Afghanistan	86.5	Mauritania	33.9
Bangladesh	287.5	Mozambique	61.0
Benin	31.3	Nepal	37.3
Bhutan	2.5	Niger	33.7
Bolivia	90.7	Pakistan	546.3
Burkina Faso	31.6	Rwanda	43.8
Burma	137.0	St. Kitts and Nevis	4.5
Burundi	42.7	St. Lucia	7.5
Cape Verde	4.5	St. Vincent	4.0
Cent. African Rep.	30.4	Sao Tome and Principe	4.0
Chad	30.6	Senegal	85.1
China, P.R. of	2,390.9	Sierra Leone	57.9
Comoros	4.5	Solomon Islands	5.0
Djibouti	8.0	Somalia	44.2
Dominica	4.0	Sri Lanka	223.1
Equatorial Guinea	18.4	Sudan	169.7
Ethiopia	70.6	Tanzania	107.0
Gambia, The	17.1	Togo	38.4
Ghana	204.5	Tonga	3.3
Grenada	6.0	Uganda	99.6
Guinea	51.9	Vanuatu	9.0
Guinea-Bissau	7.5	Viet Nam	176.8
Guyana	49.2	Western Samoa	6.0
Haiti	44.1	Yemen Arab Republic	43.3
India	2,207.7	Yemen P.D.R.	77.2
Kampuchea, Democratic	25.0	Zaire	291.0
Kenya	142.0	Zambia	270.3
Kiribati	2.5		
Lao, P.D.R.	29.3		
Lesotho	15.1	Total	8,790.4
Liberia	71.3		
Madagascar	66.4		
Malawi	37.2		
Maldives	2.0		
Mali	50.8		

TABLE 3

Contributions to the ESAF
(as of 12/31/88; millions of SDRs)

	Grants or Grant Equivalents*	Loans
Japan	309	2,200
France	(326)	800
Germany	130	700
Italy	(172)	370
Canada	(140)	300
Switzerland	(101)	200
U.K.	440	--
19 other countries**	(449)	744
	2,167	5,314

* For the figures in parentheses, the grant equivalent has been estimated by Treasury staff.

** The commitments of these countries have not yet been made public.

Table 4

SAF and ESAF Arrangements
(as of December 31, 1988; millions of SDRs)

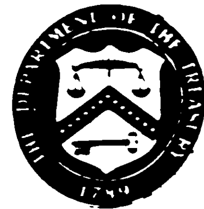
Member	Date of Arrangement	Date of Expiration	Amount Agreed	Undrawn Balance
Structural Adjustment Facility Arrangements				
Bangladesh	February 6, 1987	February 5, 1990	182.56	---
Burundi	August 8, 1986	August 7, 1989	27.11	5.76
Central African Rep.	June 1, 1987	May 31, 1990	19.30	4.10
Chad	October 30, 1987	October 29, 1990	19.43	13.31
Dominica	November 26, 1986	November 25, 1989	2.54	---
Equatorial Guinea	December 13, 1988	December 12, 1991	11.68	8.00
Guinea	July 29, 1987	July 28, 1990	36.77	25.19
Guinea Bissau	October 14, 1987	October 13, 1990	4.76	3.26
Haiti	December 17, 1986	December 16, 1989	28.00	19.18
Kenya	February 1, 1988	January 31, 1991	90.17	61.77
Lesotho	June 29, 1988	June 28, 1991	9.59	6.57
Madagascar	August 31, 1987	August 30, 1990	42.16	28.88
Mali	August 5, 1988	August 4, 1991	32.26	22.10
Mauritania	September 22, 1986	September 21, 1989	21.53	4.58
Mozambique	June 8, 1987	June 7, 1990	38.74	8.24
Nepal	October 14, 1987	October 13, 1990	23.69	5.04
Sierra Leone	November 14, 1986	November 13, 1989	36.77	25.19
Somalia	June 29, 1987	June 28, 1990	28.07	19.23
Sri Lanka	March 9, 1988	March 8, 1991	141.67	97.05
Tanzania	October 30, 1987	October 29, 1990	67.95	14.45
Togo	March 16, 1988	March 15, 1991	24.38	16.70
Uganda	June 15, 1987	June 14, 1990	63.25	13.45
Zaire	May 15, 1987	May 14, 1990	184.79	126.59
Total			1,137.15	528.62
Enhanced Structural Adjustment Facility Arrangements				
Bolivia	July 27, 1988	July 26, 1991	136.05	113.38
Gambia	November 23, 1988	November 22, 1991	20.52	17.10
Ghana	November 9, 1988	November 8, 1991	368.10	281.80
Malawi	July 15, 1988	July 14, 1991	55.80	46.50
Niger	December 12, 1988	December 11, 1991	50.55	42.13
Senegal	November 21, 1988	November 20, 1991	144.67	114.89
Total			775.69	615.79

Table 5

IMF Enhanced Structural Adjustment Facility
Subsidy Account
FY 1990 Request
($ thousands)

Fiscal Year	Budget Authority	Outlays
1990	150,000	3,000
1991	0	5,000
1992	0	8,000
1993	0	11,000
1994	0	13,000
Subtotal	150,000	40,000
1995-2001	0	110,000
Total	$150,000	$150,000

TREASURY NEWS



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

CONTACT: Office of Financing
202/376-4350

DOM 5310

FOR IMMEDIATE RELEASE
April 17, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,203 million of 13-week bills and for $7,201 million of 26-week bills, both to be issued on April 20, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 20, 1989			:	26-week bills maturing October 19, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.55% a/	8.86%	97.839	:	8.56%	9.07%	95.672
High	8.59%	8.90%	97.829	:	8.61%	9.13%	95.647
Average	8.57%	8.88%	97.834	:	8.59%	9.11%	95.657

a/ Excepting 1 tender of $10,000.

Tenders at the high discount rate for the 13-week bills were allotted 48%.
Tenders at the high discount rate for the 26-week bills were allotted 14%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 41,970	$ 41,970	:	$ 28,035	$ 28,035
New York	20,330,520	6,110,520	:	19,620,080	6,107,080
Philadelphia	30,825	30,825	:	28,215	28,215
Cleveland	43,735	43,735	:	30,580	30,580
Richmond	57,610	47,610	:	47,105	47,105
Atlanta	36,135	36,135	:	33,230	33,230
Chicago	1,268,640	136,240	:	1,121,555	157,055
St. Louis	47,525	27,525	:	35,840	27,840
Minneapolis	8,395	8,395	:	10,550	10,550
Kansas City	47,740	47,740	:	48,320	48,320
Dallas	35,870	28,270	:	28,430	23,430
San Francisco	947,850	243,835	:	1,123,485	177,485
Treasury	400,375	400,375	:	481,690	481,690
TOTALS	$23,297,190	$7,203,175	:	$22,637,115	$7,200,615
Type					
Competitive	$19,604,580	$3,510,565	:	$17,666,955	$2,230,455
Noncompetitive	1,267,510	1,267,510	:	1,094,460	1,094,460
Subtotal, Public	$20,872,090	$4,778,075	:	$18,761,415	$3,324,915
Federal Reserve	2,313,700	2,313,700	:	2,000,000	2,000,000
Foreign Official Institutions	111,400	111,400	:	1,875,700	1,875,700
TOTALS	$23,297,190	$7,203,175	:	$22,637,115	$7,200,615

1/ Equivalent coupon-issue yield.

NB-224

TREASURY NEWS

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

FOR RELEASE ON DELIVERY
EXPECTED AT 11:00 A.M.
April 18, 1989

STATEMENT OF THE HONORABLE
DAVID W. MULLINS, JR.
ASSISTANT SECRETARY OF THE TREASURY
(DOMESTIC FINANCE)
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS

Mr. Chairman and Members of the Committee:

I welcome the opportunity to participate in your examination of Federal credit reform and borrowing by off-budget agencies. I also want to take this opportunity to seek your support of the Administration's credit reform proposal, H.R. 1127.

Over the years the Treasury has been involved in a number of policy initiatives designed to control the growth and cost of Federal and federally-assisted credit. The Federal Government is the largest financial intermediary in the United States. At the end of 1988, the Government held $222 billion of outstanding direct loans (including $124 billion financed by the Federal Financing Bank) and had another $550 billion in outstanding guaranteed loans (including $451 billion of FHA and VA mortgages and $48 billion of guaranteed student loans). Government-sponsored enterprises, such as the Federal National Mortgage Association and the Federal Home Loan Banks, had an additional $666 billion of outstanding loans at the end of the year. Thus, directly or indirectly, the Government had influenced the allocation of $1.4 trillion of outstanding credit to farmers, homeowners, small businesses, exporters, utilities, shipbuilders, and State, local and foreign governments.

While much public attention is focused on direct Treasury borrowing to finance budget deficits, much less attention has been focused on federally-assisted borrowing in the form of off-budget guaranteed loans and borrowing by off-budget Government-sponsored enterprises. Yet, of the estimated $193 billion of net Federal and federally-assisted borrowing in FY 1990, 46 percent is for financing the budget deficit, 17 percent for financing off-budget Federal loan guarantee programs, and 37 percent for financing off-budget GSEs. Taken together, it is clear that off-budget credit assistance from the Federal Government will be the largest component of total borrowing under Federal auspices in FY 1990.

Guaranteed borrowing

Under present budget scorekeeping, loan guarantees appear to be essentially costless at the time the guarantee is issued, regardless of how much subsidy may be implicit in the program. Additionally, some Federal guarantees underwrite debt financed in competition with direct Federal borrowing, and the impact of such borrowing is like Treasury borrowing to finance direct loans and has a similar adverse impact on private credit markets and interest rates.

A major reason for the growth in loan guarantees is the intense scrutiny given in the budget process to the deficit in the up-coming budget year. Loan guarantees have a negligible impact on the budget deficit in the year in which the guarantee is issued. That is, unlike direct loans which result in immediate budget outlays in the full amount of the disbursement, loan guarantees are reflected in the unified budget outlay totals only over time, to the extent of program administrative expenses, the cost of future defaults, and in some cases, direct cash interest subsidies. Thus, guarantees provide significant benefits to borrowers with substantially less near-term budget impact than providing the same level of benefits in the form of direct loans. Consequently, there has been a marked shift from direct to guarantee loan programs by those wanting to expand Government programs with minimal near-term budget effect. In addition, there has been a pronounced shift from Government guaranteed debt financed by local lending institutions to debt financed directly in the securities market. These trends have contributed to the significant growth in guarantee programs which has occurred over the last decade.

While the problem of the budget treatment and control of guaranteed loans has remained unsolved, considerable progress has been made with respect to the efficient financing of Federal credit programs.

Federal Financing Bank

At the request of the Treasury, the FFB was established by Congress in 1973 to deal with severe debt management problems resulting from years of off-budget financing which had flooded the Government securities market with a variety of Government-backed securities. These securities were financed outside the Treasury by various Federal agencies in the form of direct agency issues, sales of loan assets with Federal guarantees, and guarantees of obligations of private borrowers. Although the securities were backed by the Government, they sold at relatively high interest rates and fees. These securities also competed with Treasury securities, undermined Treasury debt management policies, created serious marketing problems, and placed Treasury in a position of acquiescing to agency financings

on terms which Treasury believed did not reflect the full value of the Government backing.

The FFB was a response to a need for control and rationalization of the financing of Federal programs, primarily credit assistance programs. This need arose from three basic trends: (1) the rapid growth of Federal credit assistance programs, (2) the shift from direct loans (on-budget) to guaranteed loans (off-budget), and (3) the shift from guaranteed loans financed by local lending institutions to guaranteed obligations financed directly in the securities markets.

The proliferation of the Government-backed securities in the market before the establishment of the FFB was very costly to the Government, and thus the taxpayer, in part because of higher transaction costs and in part because the less competitive market for the securities resulted in higher borrowing costs. For example, prior to the establishment of the FFB, obligations fully guaranteed by the Department of Defense under the foreign military sales program were financed in the securities markets at interest rates up to 2 percentage points over prevailing market yields on Treasury securities of comparable maturity. Since there is no economic difference between a guaranteed loan and a direct loan by FFB or another Federal agency, there is no reason to incur higher costs to the Government for financing guarantee programs in the private markets.

It is now widely recognized that the FFB has been successful in rationalizing Federal borrowing activity. Twenty-seven Federal agency programs of issues, sales, or guarantees of securities, totaling $146 billion of obligations outstanding at the end of FY 1988, have been financed by the FFB. (See attachment.) The consolidation of market financing by the FFB has resulted in estimated savings in program financing costs of well in excess of $1/2 billion per year, most of which are savings to the Government rather than to guaranteed borrowers.

While the FFB's primary function is debt management, the FFB has also served to facilitate the control of Federal credit programs. By consolidating the borrowing of the various agencies, the FFB has made the problem of unrestrained growth in Federal credit more visible and has underscored the need for more effective control. In addition, the FFB has served to bring to the attention of Congress the true nature and aggregate impact of these programs and has led to many Congressional hearings and studies concerning the control of Federal credit programs.

<u>Budget status</u>

Until 1985, the outlays of the FFB were off-budget, including its purchases of guaranteed loan assets from Federal agencies and its direct loans to private borrowers guaranteed by

Federal agencies. Because of its off-budget status, the FFB was sometimes wrongly criticized for being in itself a means for Federal agencies to avoid budget control of their credit programs. The FFB, however, was created strictly for the purpose of reducing the costs of Federal and federally-assisted borrowing from the public, and to assure that such borrowings are financed in a manner least disruptive of private financial markets and institutions. The FFB itself did not affect either the budget status or the authorized program levels of the agencies using the FFB. The actual allocation of budget and credit resources to various agencies and programs is determined through the budget process. Any efforts to control credit programs should be focused on the programs themselves, rather than on the FFB.

The off-budget status of the FFB was one of the issues considered in 1981 and 1982 by the Reagan Administration, when the Federal Credit Policy Working Group under the auspices of the Cabinet Council on Economic Affairs (now known as the Economic Policy Council) conducted an extensive review of the FFB in the broader context of overall Administration budget and credit program policies. That review led to the adoption of two important principles. First, the budget should include all of the Government's cash outlays to the public, including outlays to the public by the FFB, and second, all agencies should, over time, be required to finance fully guaranteed securities of a type that is ordinarily financed in investment securities markets through the FFB rather than in the securities market.

In accordance with the second principle, OMB Circular No. A-70, "Policies and Guidelines for Federal Credit Programs," re-issued in August 1984, included a requirement that fully guaranteed obligations of a type that is ordinarily financed in investment securities markets be financed by the FFB. At Treasury's request, this requirement was also included in the legislation submitted by the Reagan Administration to Congress in July 1985 to implement the first principle. If the legislation were enacted to place the FFB on-budget without the requirement, it was expected that Federal agencies would simply bypass the FFB by financing their fully guaranteed obligations directly in the securities market in order to avoid budgetary control of their credit programs. The legislation which emerged from Congress, Gramm-Rudman-Hollings, did not include the requirement for FFB financing of fully guaranteed securities of a type that is ordinarily financed in investment securities markets.

In keeping with Federal credit program policy, the Reagan Administration's credit reform legislation, submitted to Congress in 1987, 1988 and again in January 1989, included a requirement that fully guaranteed obligations of a type that is ordinarily financed in investment securities markets be financed by the FFB. The Bush Administration has endorsed the credit reform legislation, which has been recently introduced as H.R. 1127 and

S. 584. H.R. 1127 was introduced by Mr. Gradison and referred to your Committee, as well as the House Banking, Government Operations, and Rules Committees. The credit reform legislation will improve the accounting for Federal credit transactions in the budget/appropriations process by requiring credit agencies to obtain appropriations to cover the estimated subsidy costs in direct and guaranteed loans. This approach will provide a basis for direct comparisons in the budget process of the economic costs of credit subsidies with the costs of subsidies provided in the form of cash grants.

Effects of GRH

Gramm-Rudman-Hollings, which was enacted in December 1985, required all transactions of the FFB on behalf of a Federal agency to be treated as a means of financing for the agency. As a result, FFB disbursements that were formerly off-budget are now scored as budget outlays of the agency originating the transaction. Thus, without the requirement that Federal agencies finance their fully guaranteed obligations through the FFB, the GRH change in budget scoring has led to intense pressure to return to the off-budget financing of guaranteed obligations in the private market. Since 1985, legislation has been enacted which prohibited FFB financing of new loans under four guarantee programs and instead, authorized private market financing with full faith and credit guarantees.

In addition, the GRH budget scoring change led to the sale with recourse of loans in the FFB portfolio in order to reduce near-term budget deficits, at the expense of higher deficits in future years. This incentive, combined with Congressional desire to provide further subsidies to certain borrowers, prompted Congress to create prepayment programs under which rural electric cooperatives and foreign governments are authorized to prepay their FFB loans at less than their contractually defined prepayment prices and to refinance privately with Government guarantees. This procedure produces a subsidy that is determined, not on the basis of an analysis of need for subsidy, but by the happenstance of changing interest rate relationships. Moreover, this subsidy (the loss in FFB loan value at prepayment) is not appropriated by Congress to the program agency, but rather, is hidden in the cost of financing the public debt. To date, these borrowers have prepaid $9 billion resulting in associated taxpayer losses of $2 billion.

More recently, in October 1988 the President vetoed a legislative proposal to permit SBA section 503 certified development companies to prepay their guaranteed borrowings from the FFB at substantially reduced premiums and to finance the prepayments with market borrowings fully guaranteed by the Government.

As a result of the shift to market financing of new loans under programs previously financed by the FFB and the disposal of loans in the FFB portfolio, FFB financing of Federal credit programs has declined from a peak of $140 billion in 1986 to $124 billion at the end of 1988, and is projected to decline further to $86 billion at the end of 1994.

GSEs

The GRH legislation has also prompted a renewed interest, after a 15-year hiatus, in the creation of off-budget Government-sponsored enterprises. Prior to GRH, the last GSE to be created was the Student Loan Marketing Association. SLMA was created in 1972 as a part of the effort described earlier to shift the financing of guaranteed loans from the bank loan market to the securities market. Beginning in 1987, four new GSEs have been created:

- The College Construction Loan Insurance Association, created to guarantee bonds issued for college construction to fill the void which would be left by the proposed termination of on-budget direct loan programs conducted by the Department of Education.

- The Financing Corporation, created to recapitalize the Federal Savings and Loan Insurance Corporation.

- The Farm Credit System Financial Assistance Corporation (FAC), created to provide a financing mechanism for the Farm Credit System.

- The Federal Agricultural Mortgage Corporation (Farmer Mac), created to shift the financing of farm loans from the bank loan market to the securities market.

The charter of a fifth new GSE, the Farm Credit System Capital Corporation, was revoked by the legislation that created FAC and Farmer Mac.

Legislation was proposed to create a sixth new GSE, the Corporation for Small Business Investment. This legislation, which was strongly opposed by the Administration, was not adopted by the 100th Congress. COSBI would have shifted off-budget certain activities now financed on-budget by the Small Business Administration.

A seventh new entity, the Farm Credit System Insurance Corporation, was established to insure the timely payment of principal and interest on Farm Credit System obligations. This entity was initially considered to be a GSE, but upon further

examination, has been classified in the Budget as a Federal agency.

The four new GSEs which have been created differ from the older, traditional GSEs. The traditional GSEs serve as financial intermediaries to facilitate the flow of credit to private borrowers in three major areas: (1) agriculture, (2) housing, and (3) higher education. The older GSEs typically have raised funds in the capital markets in their own names or by issuing pass-through securities, and then either have lent directly to their borrower clientele or have served as financial intermediaries by providing liquidity to local lending institutions. Unlike the traditional GSEs, the four new enterprises were either established primarily to assist a Federal agency or an existing GSE, or will assist the public by insurance rather than by financial intermediation.

Mr. Chairman, you have specifically requested our assessment of four issues posed by borrowing activities of GSEs generally:

1. <u>Does GSE credit activity pose risks to the Federal Treasury</u>?

   Yes, both directly and indirectly. Several GSEs have authority to borrow from the Treasury in amounts that range up to $4 billion. These authorities would presumably be used if the institutions became financially impaired or otherwise became unable to honor their private market obligations. Some obligations issued by GSEs are guaranteed by the Government, and the Treasury is required by law to pay a significant portion of the interest on the obligations of one GSE. Moreover, participants in the Federal agency securities market have long held the view that Congress would not permit GSEs to fail. Recent Congressional actions with respect to the Farm Credit System have reinforced this view.

   In connection with potential taxpayer exposure to risks undertaken by the GSEs, the Committee might want to ask a Federal entity, such as the Congressional Budget Office, to study the relationship between risks and GSE capital and to consider whether capital standards should be established for the GSEs. Currently, the GSEs' ties to the Government permit them to operate with high ratios of liabilities to capital, compared with private enterprises, particularly when liabilities for mortgage-backed securities are taken into consideration. Such a study could address whether financial-institution type capital standards would be appropriate for the GSEs, since the GSEs perform intermediation functions that are similar to those of

financial institutions, and what existing or new entity within the Federal Government should set the capital standards. It could also address whether uniform capital standards for all GSEs would be appropriate or whether the operations are sufficiently unique to require differentiated standards.

2. Can GSE borrowing raise the cost of Federal borrowing, and if so, under what conditions?

The total volume of credit available in financial markets at any time is limited by a number of constraints, including the flow of savings and investment, and the constraints of monetary policy and the level of interest rates. While Treasury borrowing is subject to oversight and control, i.e., Treasury borrows to finance outlays authorized by Congress, and the aggregate amount of outstanding Treasury debt is limited by law, the borrowing activities of many GSEs are not so constrained. The limited supply of credit available in the economy means that increased demands from incremental borrowings of GSEs may add to pressures on interest rates and may tend to raise interest costs for all borrowers, including the Federal Government. These problems may be especially acute during periods of increased economic activity when private demands for credit rise.

3. What information is available to the Congress and the Administration on the extent of actual and contingent Federal liability created by GSE borrowing?

Although not presented and summarized succinctly, there is much useful information in the Budget on the Federal liabilities associated with GSE borrowing. For example, the Federal Government has a contingent liability for principal and interest on approximately $5 billion of Student Loan Marketing Association obligations guaranteed by the Department of Education. The Government has an actual liability for a significant portion of the interest on obligations issued by the Farm Credit System Financial Assistance Corporation, and a contingent liability for the remaining interest and all of the principal. Beginning in FY 1993, the Government will have a contingent liability for principal and interest on Farm Credit System obligations insured by the Farm Credit System Insurance Corporation. The Budget also indicates the Government will share with the private sector ultimate financial risk with respect to the Federal Agricultural Mortgage Corporation, the Federal National Mortgage

Association, and the College Construction Loan Insurance Association.

4. Under what circumstances are credit activities more appropriately conducted for budget and management purposes as on-budget borrowing by Federal agencies, rather than through GSEs?

   The question of appropriate Federal credit program management structures is distinct from the question of the appropriate budget scoring for Federal credit activities.

   Federal credit assistance programs are created primarily to address two objectives: (1) provide subsidies to particular borrowers, and (2) correct capital market imperfections and increase the amount of credit available for specific purposes. From a management perspective, it is with respect to the first objective that the need for direct Federal intervention and control is the greatest. Thus the subsidy objective has generally been addressed by programs of direct Federal loans and Federal loan guarantees, and GSEs have traditionally been created to improve the private market mechanism.

   There are a number of considerations involved in determining the appropriate budget scoring for Federal credit activities. These considerations are addressed by OMB in preparing the President's budget and by CBO in preparing the Congressional budget.

Mr. Chairman, you have also requested our response to two questions specific to REFCORP:

1. As proposed, is REFCORP structured more like an off-budget agency, or like a GSE?

   REFCORP is structured to be a Government-sponsored enterprise, rather than a Government-owned enterprise, and therefore it is excluded from the budget. Under our bill, REFCORP is a limited purpose GSE chartered by the Chairman of the Federal Home Loan Bank System. REFCORP bonds are not Treasury obligations and are not guaranteed by the Treasury. Private capital is used to fully repay principal on all debt issued. Moreover, industry funds are also used to pay interest costs, with Treasury guaranteeing the payment of any shortfall. Every dollar of Treasury funds expended is scored on budget in the year expended.

2. <u>What are the benefits and costs to the government of providing that REFCORP issue its own debt to the public, rather than rely exclusively on Treasury borrowing</u>?

The REFCORP is a special purpose financing vehicle. It has a distinct, limited life to resolve a specific problem. If enacted as proposed, Congress will limit the amount that REFCORP can borrow and provide it with no line of credit to the Treasury. We believe this type of vehicle is appropriate because it is the best way to ensure that the S&L industry pays a substantial portion of the cost to resolve its own problems. Under our plan, FHLBank earnings and S&L assessments completely cover the repayment of the principal on all debt issued, as well as a portion of the interest. This industry "self-help" feature would be jeopardized with Treasury financing, since industry funds would not be collected specifically to repay Treasury debt or meet Treasury interest payments.

In addition, the REFCORP financing mechanism requires separate and distinct accounting for all costs associated with the Administration's plan. In contrast with direct Treasury funding out of general revenues, this mechanism more easily accommodates an oversight function - such as the RTC - with direct accountability for its decisions.

Finally, Treasury financing of the plan would result in large increases in the Federal deficit in 1990 and 1991, making it virtually impossible to meet the legislated Gramm-Rudman-Hollings deficit targets. Alternative financing plans set dangerous precedents with serious implications for the financial markets.

We firmly believe that any potential cost savings from direct Treasury borrowing would be more than offset by the costs of delay, the loss of significant, up front industry contributions, and the possible costs of a market reaction to a loss of Gramm-Rudman-Hollings discipline.

This concludes my prepared statement. I will be glad to answer any questions you may have.

Attachment

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FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	September 30, 1988	FY '88 Net Change 10/1/87-9/30/88
Agency Debt:		
Export-Import Bank	$ 10,957.6	$ -1,505.8
NCUA-Central Liquidity Facility	118.1	6.8
Tennessee Valley Authority	17,131.0	745.0
U.S. Postal Service	5,592.2	1,238.8
sub-total*	33,799.0	484.7
Agency Assets:		
Farmers Home Administration	58,496.0	-6,513.0
DHHS-Health Maintenance Org.	79.5	-4.4
DHHS-Medical Facilities	96.4	-5.9
Overseas Private Investment Corp.	-0-	-0.7
Rural Electrification Admin.-CBO	4,139.2	-102.0
Small Business Administration	15.4	-4.2
sub-total*	62,826.5	-6,630.2
Government-Guaranteed Lending:		
DOD-Foreign Military Sales	16,011.7	-3,152.3
DEd.-Student Loan Marketing Assn.	4,910.0	-30.0
DOE-Geothermal Loan Guarantees	50.0	50.0
DHUD-Community Development	318.1	-6.2
DHUD-New Communities	-0-	-30.6
DHUD-Public Housing Notes +	2,037.0	-37.3
General Services Administration +	387.5	-8.0
DOI-Guam Power Authority	32.1	-1.1
DOI-Virgin Islands	26.6	-0.6
NASA-Space Communications Co. +	898.8	90.2
Navy Ship Lease Financing	1,758.9	-29.4
Rural Electrification Administration	19,205.3	-1,991.6
SBA-Small Business Investment Cos.	632.7	-107.9
SBA-State/Local Development Cos.	870.9	-28.9
TVA-Seven States Energy Corp.	2,162.4	338.7
DOT-Section 511	46.2	-9.2
DOT-WMATA	177.0	-0-
sub-total*	49,525.1	-4,954.1
grand total*	$ 146,150.5	$ -11,099.6

*figures may not total due to rounding
+does not include capitalized interest

TREASURY NEWS

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202/376-4350

FOR RELEASE AT 4:00 P.M.
April 18, 1989

APR 20 89
DEPARTMENT

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued April 27, 1989. This offering will result in a paydown for the Treasury of about $ 175 million, as the maturing bills are outstanding in the amount of $14,579 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 24, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated January 26, 1989, and to mature July 27, 1989 (CUSIP No. 912794 SS 4), currently outstanding in the amount of $ 7,426 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated October 27, 1988, and to mature October 26, 1989 (CUSIP No. 912794 SM 7), currently outstanding in the amount of $ 9,575 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 27, 1989. 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 $ 1,631 million as agents for foreign and international monetary authorities, and $ 3,265 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

10/87

TREASURY NEWS

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

TEXT AS PREPARED
FOR RELEASE UPON DELIVERY
EXPECTED AT 9:30 A.M.
APRIL 19, 1989

Prepared Statement of
Assistant Secretary of the U.S. Treasury for Policy Development
The Honorable Charles H. Dallara
before the
Subcommittee on International Economics and Trade Policy
Foreign Affairs Committee
U.S. House of Representatives

Mr. Chairman and Members of the Subcommittee:

As you know, the Administration has recently concluded a thorough review of the international debt strategy. As a result of this review, we have put forward several proposals for strengthening the debt strategy. These were outlined in a speech by Secretary of the Treasury Brady before the Bretton Woods Committee on March 10 of this year. In the short span of five weeks since this speech was made, the United States' proposals have received broad international support, and we have moved into the phase of developing details and implementing the strengthened strategy.

I welcome this opportunity, Mr. Chairman, to describe why the Bush Administration proposed changes in the previous strategy, and to provide your Subcommittee a perspective on the international debt situation and the Administration's efforts to help renew growth in debtor countries.

Review of the Previous Strategy

Much has been accomplished in recent years through the debt strategy we have had in place since 1985. A number of the major debtors have implemented vital macroeconomic and structural reforms. Steps have been taken in some countries to privatize national industries, open up their economies to greater foreign trade and investment, and expand exports. Such efforts produced results: for example, export earnings have risen steadily since 1986 and by 12 percent in 1988 alone; current account deficits have been sharply reduced since 1982; and six major debtors achieved more than 4 percent positive growth in 1988.

NB-227

These signs of progress notwithstanding, our review of the debt situation led us to conclude that several serious problems remained. Debtor reforms in several countries had not been applied consistently; low investment and capital flight continued to weaken future economic prospects; new loans from commercial banks were not always forthcoming in a timely fashion; and many debtor nations had not achieved adequate growth on a sustained basis. We recognized that these issues must be addressed if progress were to be made on international debt.

In developing our new proposals, it became clear that the key principles of the previous strategy remained valid: the need for stronger growth, debtor policy reforms, adequate external financial support, and a case-by-case approach to the unique circumstances facing individual countries. The U.S. initiative to strengthen the international debt strategy reflects our continuing commitment to these fundamental tenets.

Proposals to Strengthen the Debt Strategy

The approach proposed by Secretary Brady to strengthen the debt strategy is intended to mobilize more effective external financial support for debtor countries' efforts to reform their economies and achieve lasting growth. Our ideas build on suggestions of many throughout the world, including members of Congress. The strengthened strategy revolves around two central themes: the need to give greater emphasis to debt and debt service reduction, and the need for debtor countries to implement sound economic policies designed to encourage investment and flight capital repatriation.

These themes underlie the Administration's proposals, which will require active participation by all parties in the form of:

- Sustained implementation of sound macroeconomic and structural policies in debtor countries, with increased attention to policies that will foster new investment and flight capital repatriation.

- Continued central roles for the IMF and World Bank, emphasizing support for ongoing macroeconomic and structural reform programs -- including the areas stressed above -- and for debt and debt service reduction efforts.

- Timely and diversified financial support from commercial banks, with greater attention to debt and debt service reduction to complement new lending.

Let me elaborate on the steps needed in each of these areas.

Debtor Economic Reforms

Our suggestions highlight the need for consistent implementation of broadly-based economic reforms in debtor countries. There is no substitute for sound economic policies. No amount of debt or debt service reduction will lead to sustained economic growth without proper policies. Inappropriate policies and inconsistent implementation have often been at the heart of economic and financial problems in these countries. Each country must take the initiative to undertake such reforms, fitted to its individual needs and circumstances.

Macroeconomic reforms -- in particular sound fiscal, monetary, and exchange rate policies -- remain critical. However, they are not sufficient. Supply-side policies designed to free up rigidities, allow the marketplace to work, and boost production are essential to combining adjustment with growth. Thus, countries should pursue policies which liberalize trade, reform labor markets, develop financial markets, and privatize government enterprises. This will allow the private sector to help increase employment and efficiency. Policies should be designed with new emphasis on boosting the confidence of both foreign and domestic investors, thereby encouraging new investment and fostering flight capital repatriation.

Flight capital can offer countries an important source of foreign exchange for meeting their financing needs and their growth objectives. In this connection, debtor countries should review, among other things, their overall investment and tax regimes to remove disincentives to investment. This includes reducing or eliminating limitations on remittances of profits and dividends, which can discourage both foreign and domestic investors who have capital abroad. It also may need to involve lowering overall tax rates, broadening the tax base, and reducing capital gains and dividend taxes.

Role of the IMF and World Bank

As Secretary Brady has made clear, we believe that the International Monetary Fund (IMF) and the World Bank will need to continue to play central roles in the strengthened debt strategy, although their roles will be modified to reflect the new areas of emphasis. The policy reforms fostered by these institutions to produce key macroeconomic and structural changes and sustained economic growth remain critical to the resolution of debt problems. We believe that the IMF and World Bank's ability to promote reform and mobilize financial resources can, however, be more effectively harnessed to strengthen the international debt strategy. In our view, this can be achieved through:

- o additional emphasis on policies to promote foreign direct investment and flight capital repatriation, and

- by making available some Fund and Bank resources to support directly debt and debt service reduction.

The World Bank and IMF have built impressive expertise in helping countries design and implement critical macroeconomic and structural reforms to facilitate economic recovery. These institutions have already made significant contributions to reforms in many countries, but there is clearly more to be done. Large fiscal deficits, high inflation, low levels of investment, and structural rigidities which hinder the efficient functioning of the marketplace continue to plague many debtor countries. The Fund and the Bank must continue to help debtors attack these and other problems. In addition, the World Bank should give particular emphasis to direct investment policies, while the Fund should concentrate on the flight capital problem.

We have further proposed that the IMF and World Bank provide direct financial support for voluntary debt and debt service reduction. Programs to support debt reduction should be available to countries with medium-term commercial bank debt which have a balance of payments need and are prepared to negotiate strong economic reform programs with the IMF and World Bank. Such support by the international financial institutions would be available only when countries have been able to negotiate with their commercial banks transactions involving significant debt or debt service reduction. In such circumstances, the IMF and World Bank should make available two types of financial support for debt and debt service reduction.

First, we have suggested that the IMF and World Bank modify their policy-based lending operations to help finance specific debt reduction transactions. This could be achieved by setting aside a portion of participating nations' policy-based loans to collateralize discounted debt-for-bond exchanges, or to replenish foreign exchange reserves following a cash buyback, once such transactions have been negotiated with commercial banks.

In addition, we believe that the Fund and the Bank should make available limited interest support for transactions involving significant debt or debt service reduction. Such support, which should be structured so as to safeguard the financial positions of the Fund and the Bank, could be made available on a rolling basis for a limited period of time, such as one year.

It will be important to preserve close association between debtor country performance, IMF and World Bank financing, and commercial bank activity. At the same time, rigidities in the current system have in some cases made it more difficult for debtor nations to perform well under reform programs. When a country is launching a major economic reform effort, it needs to have visible, meaningful support from the international

community from the outset. We believe, therefore, that the Fund and the Bank should review their policies in this area to introduce greater flexibility in the timing of financial disbursements. Initial disbursements from the Fund and the World Bank might, therefore, be made before final agreement is reached with commercial banks on specific debt and debt service reduction transactions.

Support from Commercial Banks

Active participation by the banking community in this effort will be a critical element of the strengthened debt strategy. As I have already indicated, a major feature of our proposal is debt and debt service reduction, to complement new money. A major advantage of this approach is that it will allow banks to choose what form their support will take from a diversified set of choices, including debt reduction, debt service reduction, or various forms of new lending mechanisms.

Certain steps need to be taken, however, to enable such diverse financial support for debtor countries to come forward in a timely and efficient manner. In particular, attention needs to be focused on existing loan agreements between debtors and commercial bank creditors, which contain elements impeding debt and debt service reduction. Such contractual constraints can be waived through negotiations between each debtor and its creditors in order to allow debt and debt service reduction transactions to proceed. These waivers might have a three-year life in order to stimulate reduction of debt burdens within a relatively short time period.

We expect waivers to accelerate the pace of debt reduction, thus benefiting debtor nations and reducing new financing needs to more manageable levels. Once waivers are agreed upon, debtors and creditors should be able to negotiate a range of specific transactions, which might include debt/bond exchanges, cash buybacks, and interest reduction instruments. At the same time, effective debt/equity programs should be in operation in the debtor nations in order to permit continued conversions of external obligations into investment instruments.

It will be important that the banking community also continue to provide new lending, although the magnitudes required should be reduced by the debt and debt service reduction operations. New financing could include concerted lending, club loans, trade credits, or project finance.

Creditor governments, for their part, should continue to reschedule official debts in the Paris Club and maintain export credit cover for debtor nations adopting Fund and World Bank programs. Regulatory, accounting, and tax regimes should also be reviewed, with a view to reducing any impediments to debt and debt service reduction. Where possible, creditor governments should also provide bilateral funding in support of the

strengthened debt strategy. Japan has already risen to this challenge by announcing a commitment to provide additional financing of $4.5 billion. We welcome this announcement, which underscores Japan's strong support for the strengthened debt strategy.

Questions Raised about the Strengthened Debt Strategy

A number of questions have arisen concerning the strengthened debt strategy, and I would like to address a few of these.

Many have asked whether our initiative is "enough" to bring real progress in easing debt burdens. I believe that the answer to that question is yes. We see great potential in the combination of debt and debt service reduction, new lending, foreign direct investment and flight capital repatriation to provide adequate support for individual country efforts. The real issue is not whether there is a specified amount of debt reduction in a certain period of time but whether the combination of debt reduction, debt service reduction, and new money provided will be sufficient to reinforce domestic economic reform and foster sustained economic growth. Viewed in that light, the amount of debt reduction needed will vary from case to case, depending in part on the debtors priorities and circumstances.

It is important to understand that, while there is urgency to getting the process of debt reduction under way, the process is likely to be an incremental one, with possibly modest activity at the outset leading to greater debt reduction over time as market innovations appear and the catalytic process unfolds. In fact, we believe that it is important that the initial steps in this process be realistic and practical, in order to permit it to move ahead promptly. Exaggerated or grandiose demands for debt relief could actually slow the process. By opening up the market to debt and debt service reduction transactions, however, and building on the experience gained, we believe the international community can achieve significant results for debtor countries.

In discussing the strengthened strategy, some have also asked which countries would be eligible. Developing countries from all parts of the world stand to benefit from this initiative. In developing these proposals, we have consciously extended our focus from the major fifteen debtors to a broader group of countries experiencing difficulties in servicing their commercial bank obligations. By negotiating a comprehensive reform program with the IMF/World Bank, any country with medium-term commercial bank debt can become a candidate for IMF and World Bank support of its debt and debt service reduction efforts.

Many of the potential candidates are of particular strategic and political interest to the United States. Several potential

early candidates for such support have already emerged. Both Mexico and the Philippines have now completed negotiations with the IMF management on comprehensive economic reform programs which should provide a solid foundation for their negotiations with the commercial banks. Venezuela is also well along in this process as well and has already drawn money from the IMF to support its initial reform efforts. Morocco is also in the process of negotiations with the international financial institutions and commercial banks and stands ready to benefit from a strengthened strategy.

Specific questions have arisen about how the "good performers" would be treated under this initiative. We recognize that some countries that would be eligible for a debt reduction program have already made considerable progress. Chile's intensive reform efforts, for example, have helped create a more efficient and competitive economy and, among other things, produced probably the most open investment regime in Latin America. Chile has benefited from real growth exceeding 5 percent for the past three years and a very low level of inflation. Colombia has also made significant progress, while avoiding formal debt rescheduling. Under an IMF enhanced surveillance program, it has virtually eliminated its fiscal deficit, while increasing its international competitiveness The reward has been GDP growth averaging over 5% in the 1986-88 period. Other debtors, such as Uruguay, have also made major strides.

Some of these countries may wish to continue to rely upon the support of the Fund and the Bank without taking advantage of the new proposals. If so, they should be encouraged in their efforts, where sound policies remain in place. Others of these countries may wish to consider taking advantage of the potential benefits of the proposals we have made. They also should be supported.

We feel that a strengthened international debt strategy will help debtor countries address more successfully the myriad of problems they have been facing, some of which are compounded by unwieldy external obligations. We realize that the economic measures involved in this approach will not be any easier now than they have been; the benefits, however, will be more visible, thus providing greater encouragement for these difficult reform efforts.

International Support

Earlier this month, many of the parties involved in addressing international debt problems converged on Washington for the Spring Meetings of the IMF and World Bank. During that time, we presented in a number of fora our ideas for strengthening the debt strategy. These ideas received much attention and strong support from the Group of Seven and Group

of Ten industrial nations and both the Interim and Development Committees of the IMF and World Bank.

For example, the Interim Committee, which represents the views of both debtor and creditor governments, welcomed the U.S. proposals to strengthen the debt strategy and "requested the [IMF] Executive Board to consider as a matter of urgency the issues and actions involved." In particular, the Committee agreed that "the Fund should provide resources in appropriate amounts to members to facilitate debt reduction" and that "the question of provision of resources for limited interest support transactions involving significant debt or debt service reduction should be examined."

Next Steps

It is critical now that we build upon the momentum established by these meetings and take the steps necessary to flesh out the strengthened debt strategy. Debtor countries are anxious to proceed with debt reduction, and we would like to move forward as quickly as possible. We believe that it is important that this occur without delay as part of ongoing negotiations between debtors and creditors.

We anticipate that the Executive Boards of the IMF and World Bank will meet in the next few weeks on the key issues before these institutions, and we hope they will reach decisions at an early stage about how to put the necessary mechanisms into place. In the meantime, commercial banks and debtor countries can move ahead in developing specific debt reduction and debt service reduction transactions. They should also be preparing the way for such transactions to go forward by negotiating waivers that remove the contractual constraints on debt and debt service reduction.

We believe that a dynamic process has been set in motion whereby each country can work with its creditors to reach agreement on a diverse range of financial support. We look to the process itself to generate new and innovative debt and debt service reduction techniques, differentiated new money mechanisms, and other diversified forms of financial support. In addition, to the basic process of debt reduction, these activities can include debt swaps that directly benefit the public interest. Just last week, for example, three conservation organizations signed an agreement to retire $9 million of Ecuador's commercial bank debt in exchange for local currency bonds which will fund environmental and conservation projects. We heartily support such private sector initiatives.

In closing, I want to emphasize that the Administration's intent in strengthening the international debt strategy is to promote an approach to debt problems that will help revive growth and renew hope in developing countries. To achieve progress, the strengthened strategy will depend on continued

cooperative efforts of commercial banks, debtor and creditor governments, and the international financial institutions. Secretary Brady and the Bush Administration are fully committed to making this process work, and we look forward to strong Congressional support for these efforts.

Thank you.

TREASURY NEWS

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FOR IMMEDIATE RELEASE
April 19, 1989

CONTACT: Larry Batdorf
(202) 566-2041

AGES PLEADS GUILTY TO SOUTH AFRICA EMBARGO VIOLATIONS

The United States Treasury Department today announced that on April 5, 1989, in the United States District Court for the Eastern District of New York, co-defendants Air Ground Equipment Sales, Inc. (AGES) and Robert G. Fessler, Chairman and Chief Executive Officer of AGES, pleaded guilty to criminal charges of illegal imports of merchandise purchased from South African Airways, a South African parastatal organization.

The corporation has entered pleas of guilty to violation of the parastatal import ban of the Comprehensive Anti-Apartheid Act (CAAA) and to smuggling, and has agreed to pay a $1 million fine, the maximum criminal penalty authorized under the law. The four jet engines, engine stands, and accompanying materials, which have a combined domestic value of $7.5 million, will be forfeited under U.S. Customs Service regulations.

Fessler pleaded guilty to one felony count of violating the parastatal import ban of the CAAA, which carries a maximum criminal penalty of up to $50,000 and/or ten years imprisonment. Sentencing is scheduled for June 9, 1989, in the U.S. District Court for the Eastern District of New York in Brooklyn.

AGES is headquartered in West Babylon, New York, and maintains offices throughout the United States and around the world. It engages in the buying, selling, and leasing of aircraft parts. The four engines in question, were purchased by AGES from South Africa in 1987 through an international broker.

The defendants falsified shipping and Customs documents in order to transship the engines and related materials to the United States through Israel. Using the falsified documents, AGES cleared the goods through U.S. Customs in August 1987. On November 5, 1987, the U.S. Customs Service seized the engines at AGES' headquarters pursuant to a search warrant. The Government of Israel and South African Airways cooperated in the investigation.

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Salvatore R. Martoche, Assistant Secretary of the Treasury for Enforcement, said, "The guilty pleas by AGES represent a major victory in the Treasury Department's on-going efforts to enforce vigorously the CAAA prohibitions on imports from South African parastatal organizations."

Martoche also said, "This case should send a strong message that violations of the South African sanctions program will not be tolerated. The outcome is the result of a joint effort and close cooperation among the U.S. Customs Service and the Office of Foreign Assets Control, both agencies of the Treasury Department. These two Treasury agencies will continue to work closely with the Department of Justice to pursue a vigorous enforcement program against violations of the South African sanctions."

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
April 19, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION $9,250 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $9,250 million of 2-year notes to refund $10,879 million of 2-year notes maturing April 30, 1989, and to pay down about $1,625 million. The public holds $10,879 million of the maturing 2-year notes, including $1,357 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $9,250 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, Federal Reserve Banks, for their own accounts, hold $777 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.

oOo

Attachment

NB-229

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED MAY 1, 1989

April 19, 1989

<u>Amount Offered</u>:

To the public	$9,250 million

<u>Description of Security</u>:

Term and type of security	2-year notes
Series and CUSIP designation	Y-1991 (CUSIP No. 912827 XL 1)
Maturity date	April 30, 1991
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

<u>Terms of Sale</u>:

Method of sale	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None

<u>Payment Terms</u>:

Payment by non-institutional investors	Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts ...	Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions	Acceptable

<u>Key Dates</u>:

Receipt of tenders	Wednesday, April 26, 1989, prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):	
a) funds immediately available to the Treasury ..	Monday, May 1, 1989
b) readily-collectible check ..	Thursday, April 27, 1989

TREASURY NEWS

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

Text As Prepared
Embargoed For Release Upon Delivery
Expected at 10:00 a.m., D.S.T.

ROOM 5310

STATEMENT OF THE HONORABLE NICHOLAS F. BRADY
SECRETARY OF THE TREASURY
HOUSE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON TREASURY, POSTAL SERVICE
AND GENERAL GOVERNMENT
APRIL 20, 1989

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE:

I am pleased to be here today to discuss with you the operating budget request for the Department of Treasury for Fiscal Year 1990.

Over the past few weeks, I have testified before the Senate and the House Budget Committees and Appropriations Committees as one of the Administration's economic spokesmen. We talked about President Bush's key budget proposals, including funding to win the war against drugs, to emphasize education and environmental issues, and plans to assist the homeless. We also talked about the Administration's plan to resolve the savings and loan crisis, important revenue related measures, and the need to improve our competitive position in the world economy.

My remarks, today, focus not on the economic and tax policy underlying the President's budget, but on that portion of the overall budget that pertains to the operations of the Department of the Treasury. As you are aware, the President's Fiscal Year 1990 Budget proposes freezing, at Fiscal Year 1989 levels, the aggregate spending of domestic programs not directly associated with one of his five broad initiatives. The Administration strongly encourages full funding of the Department's $0.5 billion request to continue the War on Drugs, including the increases proposed by President Bush to increase cargo inspections for drug smuggling and expand efforts to fight money laundering.

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Although most of our programs are included in the aggregate domestic discretionary spending category, the President has emphasized that the freeze is flexible, allowing some programs to increase while others are reduced. Discussions concerning increases or decreases to specific programs within the freeze category are ongoing between Congressional leaders and Administration officials.

The Department of the Treasury carries out a wide variety of functions that are critical to the functioning of our Nation's government. These activities include:

- o Administering the Nation's tax system and collecting the revenues due under our tax laws;

- o Managing the government's finances, by financing the debt, paying obligations, and maintaining the fiscal accounts;

- o Collecting customs duties at our Nation's borders; interdicting illegal and dangerous drugs; and providing for the protection of the President and the Vice President; and

- o Assisting the President in directing the Administration's domestic and international economic policies, monetary and financial affairs, and tax policies.

For Fiscal Year 1990, the Department is requesting a total of $8.0 billion and 155,748 full time equivalent positions for the purpose of carrying out these critical responsibilities. This request represents an increase of $311 million and 1,990 full time equivalent positions compared to Fiscal Year 1989.

I would like to highlight a number of objectives of our Fiscal Year 1990 budget request:

I. Our key priority is to maintain an effective tax administration system by transforming many manual, paper-intensive operations into a modern, automated system capable of delivering first quality service while processing returns and collecting revenues.

The Department's budget for the Internal Revenue Service, the largest Treasury bureau, takes account of the continued growth in tax administration workload and the pressing need for modernized systems. For the IRS, this entails pursuing the redesign of our current tax processing system--a system first introduced in the early 1960's, but today, aged and deficient in terms of available technology. This budget request will not only help guarantee the efficient collection of tax revenues through the turn of the century, but also will provide for the continuing improvement in service levels that the taxpaying public expects and deserves, reducing response times from weeks and days, in some cases, to a matter of minutes.

II. Our second objective is to maintain the ability of the Internal Revenue Service to promote tax compliance and collect revenue, while supporting improvements in these areas.

Improving service levels through modernization of tax collection systems will provide a necessary boost to our ability to promote tax compliance. However, the request for the IRS also contains the funds necessary to improve important, ongoing revenue enforcement activities. We propose to accomplish this objective by increasing resources for several high yielding revenue efforts, including the collection of unpaid taxes, compliance efforts among U.S. citizens living abroad, and investigations into possible underpayment of employment taxes.

Finally, we plan to augment the IRS' ability to perform examinations of tax returns where there are simple discrepancies that have a revenue impact.

The Bipartisan Budget Agreement for FY 1990 was approved last week by the President and the Congressional leaders of both parties. Incorporated into that agreement are $0.5 billion in additional revenues to be derived from expanded IRS tax enforcement efforts. To meet this target, additional resources will be required for IRS enforcement programs above the FY 1989 enacted levels. After the new resource requirements are determined, they will be provided to the Congress as part of the continuing negotiations on the FY 1990 budget.

III. A third objective is to support the President in his efforts to end the scourge of drugs by promoting the Department's role in drug law enforcement.

The role of the U.S. Customs Service in inspecting the people and goods crossing our Nation's borders places the Department of the Treasury at the forefront of President Bush's efforts to stem the tide of illegal drug trafficking. In Fiscal Year 1990, the Customs Service will continue to participate in drug enforcement task forces in major cities across the Nation and to increase drug interdiction efforts along our borders. The Department is requesting the additional resources to expand contraband examinations and improve automated systems that support investigative and intelligence operations. We also seek continued development and refinement of automated systems such as the Customs' Automated Commercial System to enhance productivity and improve the effectiveness of operations.

IV. Our next major objective is to fulfill our other law enforcement and protection responsibilities, including the continued enforcement of the Nation's trade laws.

The Department's budget requests funds for continuing law enforcement and support operations provided by the Federal Law Enforcement Training Center, the Customs Service, the Bureau of Alcohol, Tobacco and Firearms, and the Secret Service.

Considering Treasury's pivotal involvement in Federal law enforcement and our critical need to both hire and retain the most highly skilled law enforcement personnel, the Department supports the work of the National Advisory Commission on Law Enforcement. We need a fair compensation system, applicable to all Federal law enforcement personnel, to confront recruitment and retention problems, and to address the compensation issue as it relates to other Federal, state, and local law enforcement agencies.

We also remain committed to the concept of consolidated training in order to take advantage of scale economies and address the shared needs of our Nation's diverse law enforcement personnel. The request for the Federal Law Enforcement Training Center will support a facility that fully meets the basic and advanced law enforcement training needs of the participating agencies.

In addition to the drug interdiction efforts already mentioned, the Department proposes to provide funding for the Customs Service that will allow the collection of $19 billion in revenue through the enforcement of the Nation's trade laws. The Department's proposed funding will support the rapid inspection and clearance of 9.8 million formal merchandise entries and 370 million passengers.

We seek funds for the Bureau of Alcohol, Tobacco and Firearms to continue conducting programs to reduce the criminal use of firearms and explosives. In addition, funding the

operations of the Bureau will provide for the collection of an estimated $10.3 billion in excise taxes on alcohol and tobacco.

The proposed budget for the Secret Service takes into account the need for improved security at the Vice President's residence, vital upgrades to information and communications systems, and improved administration of responsibilities that include the protection of the President and the Vice President, and the investigation of currency counterfeiting, check forgery, and other types of fraud.

V. The Department's fifth objective is to continue to effectively manage the Nation's finances and service America's debt.

The request for the fiscal service bureaus--the Financial Management Service and the Bureau of Public Debt--furthers our efforts to improve governmentwide cash management, debt collection, financial information systems, customer service to holders of government securities, and the cost effectiveness of the Savings Bonds program.

As the lead agency for many of these issues, the Financial Management Service has presided over a substantial accomplishment--the generation of measurable savings of over $20 billion during the 1980's through more effective processing of the Federal government's $2.3 trillion annual cash flow. Over the last few years, the Financial Management Service has been called on to increase its leadership role in the financial management of the Federal government. The Service's proposed budget for Fiscal Year 1990 reflects this active role as well as the need to sustain the systems modernization necessary for ensuring financial management services in the future.

The Department's proposed budget for the Bureau of Public Debt will provide funding to fully reimburse the Federal Reserve Banks for services performed as fiscal agents on behalf of the Bureau. Additionally, funding is provided to handle workload associated with the new Education Savings Bonds program and to develop a new savings bonds processing system to maintain the records of the 5.4 billion savings bonds that the public now owns. We also expect that through continued enhancement of automated systems, we will improve our ability to render better accounting and servicing of the Public Debt.

VII. Another major objective is to provide continued support for policy formulation and management oversight of all Departmental operations.

The budget request for Treasury's Departmental Offices will support the Department in its efforts to assist the President in the formulation of tax and economic policy--both national and international. It will also fund continued management oversight of the Department's diverse operations, including the establishment of an assertive and independent statutory Inspector General.

VI. Our final objective is to supply the resources necessary to provide for the Nation's coinage and currency demands.

The Bureau of Engraving and Printing does not require appropriated funds for currency production. The requested funding for the U.S. Mint will allow for the production of sufficient coinage to meet the Nation's business needs. The budget will also fund efficiency improvements that will enhance our capabilities to manufacture domestic coinage.

In summary, the $8.0 billion budget request for the Department of the Treasury represents:

- a faithful commitment to carrying out President Bush's charge to restrain the growth of government, while providing vital Federal services;

- a vital investment in the ability of the Department to manage its tax collection, financial management, and debt accounting roles;

- a necessary license to support the President's war on drugs through increased interdiction and other law enforcement duties; and

- a mandate to carry out many of the most essential functions of the Federal government.

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

TREASURY NEWS

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FOR IMMEDIATE RELEASE
APRIL 19, 1989

CONTACT: ART SIDDON
566-5252

STATEMENT BY
SECRETARY OF THE TREASURY
NICHOLAS F. BRADY

The Senate deserves a great deal of credit for acting swiftly to pass President Bush's savings and loan reform plan. In fending off amendments to the financing mechanism, the Senate has upheld the integrity of the Gramm-Rudman-Hollings process. We also applaud the Senate's efforts to maintain strong capital requirements. We particularly appreciate the bipartisan leadership and cooperation shown in this effort.

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TREASURY NEWS

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FOR IMMEDIATE RELEASE April 20, 1989

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of March 1989.

As indicated in this table, U.S. reserve assets amounted to $49,854 million at the end of March, up from $49,373 million in February.

U.S. Reserve Assets
(in millions of dollars)

End of Month	Total Reserve Assets	Gold Stock 1/	Special Drawing Rights 2/3/	Foreign Currencies 4/	Reserve Position in IMF 2/
1989					
Feb.	49,373	11,061	9,653	19,306	9,353
Mar.	49,854	11,061	9,443	20,298	9,052

1/ Valued at $42.2222 per fine troy ounce.

2/ Beginning July 1974, the IMF adopted a technique for valuing the SDR based on a weighted average of exchange rates for the currencies of selected member countries. The U.S. SDR holdings and reserve position in the IMF also are valued on this basis beginning July 1974.

3/ Includes allocations of SDRs by the IMF plus transactions in SDRs.

4/ Valued at current market exchange rates.

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TREASURY NEWS

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FOR IMMEDIATE RELEASE
April 24, 1989

CONTACT: Peter Hollenbach
(202) 376-4302

TREASURY APPROVES A 10-YEAR MATURITY EXTENSION FOR SAVINGS BONDS

The Department of the Treasury announced today that Series EE savings bonds with issue dates of May 1, 1981, through October 1, 1981, will be granted a 10-year maturity extension. Without this extension, the bonds would have reached their initial maturity period between May 1 and October 1, 1989. As a result of Treasury's action, Series EE bonds issued between May 1 and October 1, 1981, have been granted extended maturities ranging from May 1 to October 1, 1999. During this 10-year extension, outstanding bonds in this group will continue earning market-based interest rates.

Treasury's action continues a longstanding tradition of encouraging individuals to purchase and hold U.S. Savings Bonds. Savings bonds are an important and cost-effective source of Treasury financing and they provide a safe form of savings for all Americans. Since their interest fluctuates with market rates, savings bonds also provide competitive interest earnings. Currently more than 30 million Americans hold savings bonds valued at more than $112 billion.

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TREASURY NEWS

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CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
April 24, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,210 million of 13-week bills and for $7,203 million of 26-week bills, both to be issued on April 27, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 27, 1989			:	26-week bills maturing October 26, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.63%	8.94%	97.819	:	8.69%	9.21%	95.607
High	8.68%	9.00%	97.806	:	8.73%	9.26%	95.587
Average	8.66%	8.98%	97.811	:	8.72%	9.25%	95.592

Tenders at the high discount rate for the 13-week bills were allotted 37%.
Tenders at the high discount rate for the 26-week bills were allotted 45%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 35,035	$ 35,035	:	$ 24,730	$ 24,730
New York	18,474,615	5,953,615	:	18,586,185	5,942,285
Philadelphia	33,945	33,945	:	20,230	20,230
Cleveland	37,050	37,050	:	33,795	33,795
Richmond	82,550	73,100	:	43,930	43,930
Atlanta	30,345	30,345	:	29,155	29,155
Chicago	1,105,600	192,590	:	1,022,045	305,795
St. Louis	24,565	24,565	:	24,975	22,975
Minneapolis	7,555	7,555	:	7,160	7,160
Kansas City	34,120	34,120	:	44,970	44,970
Dallas	31,975	23,825	:	29,245	19,245
San Francisco	599,515	165,385	:	667,510	208,460
Treasury	598,610	598,610	:	500,460	500,460
TOTALS	$21,095,480	$7,209,740	:	$21,034,390	$7,203,190
Type					
Competitive	$17,774,785	$3,889,045	:	$17,165,275	$3,334,075
Noncompetitive	1,280,615	1,280,615	:	1,013,835	1,013,835
Subtotal, Public	$19,055,400	$5,169,660	:	$18,179,110	$4,347,910
Federal Reserve	1,726,260	1,726,260	:	1,600,000	1,600,000
Foreign Official Institutions	313,820	313,820	:	1,255,280	1,255,280
TOTALS	$21,095,480	$7,209,740	:	$21,034,390	$7,203,190

An additional $31,080 thousand of 13-week bills and an additional $163,120 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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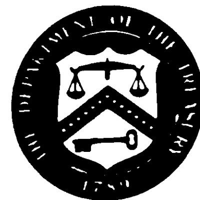
TREASURY NEWS



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JOM 5310

FOR IMMEDIATE RELEASE
April 24, 1989

CONTACT: LARRY BATDORF
(202) 566-2041

TREASURY SEEKS PUBLIC COMMENT ON PROVIDERS OF TRAVEL SERVICES AND FAMILY REMITTANCE FORWARDING TO CUBA

The Treasury Department today announced the publication in the Federal Register on April 21, 1989, of a notice requesting public comment on the fitness and qualification of providers of travel service, carrier service, and family remittance forwarding to Cuba, in connection with a new licensing requirement. The notice lists 44 applicants that have filed license applications and have been granted provisional authorization to provide services pending review of their completed applications. Only those names on this list are authorized to provide these types of services to Cuba.

On November 23, 1988, amendments to the Cuban Assets Control Regulations, 31 C.F.R. Part 515, were published to require that persons engaged in certain service transactions related to Cuba secure specific licenses from the Treasury Department's Office of Foreign Assets Control. Licenses will be issued only upon the applicant's written affirmation and subsequent demonstration that it does not participate in discriminatory practices of the Cuban government against certain residents and citizens of the United States.

Comments in response to the Federal Register notice should be submitted in writing to the Office of Foreign Assets Control, U.S. Treasury Department, 1331 G Street, N.W., Room 400, Washington, D.C. 20220. To the extent permitted by law, the identity of anyone submitting information, as well as any identifying information provided, will be held in confidence. The comment period closes on June 20, 1989.

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
April 25, 1989

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 4, 1989. This offering will result in a paydown for the Treasury of about $ 850 million, as the maturing bills are outstanding in the amount of $ 14,839 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 1, 1989. 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 4, 1988, and to mature August 3, 1989 (CUSIP No. 912794 SJ 4), currently outstanding in the amount of $ 16,621 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,000 million, to be dated May 4, 1989, and to mature November 2, 1989 (CUSIP No. 912794 TC 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 4, 1989. 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 $ 1,974 million as agents for foreign and international monetary authorities, and $ 3,767 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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.

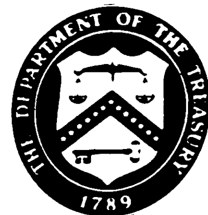
Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments 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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

10/87

TREASURY NEWS



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

FOR IMMEDIATE RELEASE
April 26, 1989

CONTACT: Office of Financing
202/376-4350

15310

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,260 million of $22,884 million of tenders received from the public for the 2-year notes, Series Y-1991, auctioned today. The notes will be issued May 1, 1989, and mature April 30, 1991.

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

	Yield	Price
Low	9.30%	99.911
High	9.35%	99.822
Average	9.34%	99.839

Tenders at the high yield were allotted 55%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 71,870	$ 71,370
New York	19,534,190	7,354,540
Philadelphia	47,935	47,935
Cleveland	102,910	102,910
Richmond	123,560	108,605
Atlanta	76,825	75,010
Chicago	1,425,620	551,630
St. Louis	160,195	110,945
Minneapolis	51,470	51,470
Kansas City	163,935	162,150
Dallas	47,120	44,855
San Francisco	935,495	435,595
Treasury	143,320	143,320
Totals	$22,884,445	$9,260,335

The $9,260 million of accepted tenders includes $1,645 million of noncompetitive tenders and $7,615 million of competitive tenders from the public.

In addition to the $9,260 million of tenders accepted in the auction process, $1,180 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $777 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-237

TREASURY NEWS

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

For Release Upon Delivery
Expected at 9:30 a.m. E.S.T.
April 27, 1989

MAY
DEPARTMENT

STATEMENT OF
DANA L. TRIER
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am here today at your request to present the Treasury Department's views on the role of qualified pension plans, in particular defined benefit pension plans, in leveraged buyouts (LBOs). The Department believes that it would be premature to change the current law regarding pension plans, particularly with respect to reversions of excess pension plan assets, in response to the LBO phenomenon.

BACKGROUND

The Internal Revenue Code provides rules designed to encourage employers to establish and maintain qualified retirement plans. Under these rules, an employer's contribution to a trust established under a retirement plan is deductible to the employer and is not included in the income of the employee. In addition, income earned by the trust assets is not currently taxable to the trust, the employer or the employees. In the case of a defined benefit pension plan, under which an employee earns credit toward a specific pension benefit, the employer is required to fund the plan under one of various actuarial funding methods in such a manner as to ensure that there are sufficient assets to satisfy pension liabilities under the plan.

If a defined benefit pension plan is terminated, plan assets in the trust must first be applied to satisfy plan liabilities. Upon satisfaction of such liabilities, plan assets remaining in the trust, so-called excess assets, may be distributed to the employer. Any such excess assets recovered by the employer are includible in the employer's income for Federal income tax purposes and are subject to a nondeductible 15% excise tax.

Excess assets may arise upon termination of a defined benefit plan because of changes in interest rates and investment performance and because of the actuarial nature of plan funding.

In determining the amount of contributions that may be made to a plan, an actuary makes certain assumptions regarding interest rates, the rate of return on plan investments, salary increases until participants' projected retirements, the rate of employee turnover, the rate of employee mortality, and other factors, any or all of which assumptions may prove to be inaccurate. Furthermore, the funding methods that may be used for budgeting the cost of projected benefits generally require minimum contributions that exceed the accrued benefits under the plan. In sum, when a plan is terminated, excess assets may exist because (1) the actual experience of the plan may be different from the assumptions made by the actuary, (2) the accrued benefits, both fixed and contingent, are less than those projected to be earned upon participants' retirements, and (3) the funding method adopted by the employer generally would have required prefunding of projected benefits.

LBO Structure. The typical LBO involves the acquisition of a public corporation by a small investor group, frequently including the target corporation's management and/or one of the LBO funds that pool capital for this purpose. The investors would ordinarily operate through a shell acquisition corporation, which would either merge with the target or make a tender offer for its stock. In either event, the target shareholders would surrender their equity interests in the target corporation for cash and/or debt of the acquisition corporation.

The equity supplied by the investor group typically represents 15 percent of an LBO's total capitalization. Around 30 percent of an LBO's total capital would be subordinated debt, initially in the form of bridge loans which would later be replaced with so-called "junk bonds." The bridge financing often comes from an investment bank, with the junk bonds purchased by investment partnerships, insurance companies, bank subsidiaries, pension funds, and tax-exempt institutions. The largest part (roughly 55 percent) of the total LBO financing would ordinarily be debt secured by the assets and receivables of the target corporation. This senior debt would typically come from a syndicate of banks, but may to a smaller extent involve insurance companies and specialized limited partnerships.

DISCUSSION

Several concerns have been raised regarding the role of pension plans, particularly pension plans with excess assets, in LBO transactions. These concerns include whether the existence of a pension plan with excess assets makes a company more attractive as a target of an LBO, whether pension plans are more likely to be terminated following a successful LBO, and the use of plans to defend against hostile takeovers (leveraged or otherwise).

Attractiveness of Overfunded Plans to Purchasers. The presence of an overfunded pension plan may make a company more attractive as a target of an LBO. Although the purchase price may reflect the value of the excess assets in the pension plan, the excess assets may be viewed as a ready source of cash that may facilitate the LBO financing. For example, the excess assets may provide a source of funds with which to retire some portion of the short-term bridge loans incurred in the transaction, or as a source of funds with which to service the debt incurred. At the same time, the Treasury Department has no empirical data suggesting that the mere presence of excess assets in a pension plan significantly contributes to the likelihood that a company will be the target of an LBO. Moreover, we would note in this regard that recently enacted legislation imposed an excise tax on asset reversions and additional limits on deductible contributions to pension plans that will have the effect of limiting the amount of excess assets that may accumulate in a pension plan. Thus, if the availability of substantial excess assets does facilitate LBOs, the new limitations may reduce this effect in the future.

Increased Likelihood of Asset Reversions. Concern has been raised whether after a successful LBO it is more likely that overfunded pension plans will be terminated. The basis for this concern is that because of the highly leveraged nature of the transaction, there is an incentive to recover the excess assets from the pension plan to facilitate servicing or retiring the debt. Although the Treasury Department has not compiled any data on this issue, the PBGC has compiled some data, which they will address in their testimony before the subcommittee.

If plan terminations are more frequent in the context of LBOs, much of this activity may well be a result of the highly leveraged structure of the transaction. The excess assets might be used to pay interest on the overall debt incurred in the transaction, or to retire some of the bridge loans. Alternatively, the pension plan, whether or not it has excess assets, might be terminated to reduce future expenses. In some cases, because the purchase price would normally reflect the presence of excess assets, the existence of the excess assets may actually result in additional debt incurred in the LBO to finance the acquisition of the excess assets. In this case, the plan might be terminated to retire the additional debt that was incurred effectively to "acquire" the plan.

In some cases, however, the pension plan might be terminated, or replaced with another type of plan, for reasons not directly related to the leveraged nature of the transaction. Thus, for example, elimination of a pension plan may reflect a different philosophy of the new management toward employee benefit plans; new management might, for example, replace the defined benefit plan with a defined contribution plan to which contributions are contingent on profits. Similarly, if a significant portion of the underlying business of the target company is sold

off after the LBO, many of the participants in the pension plan may no longer remain with the company, and the role of the pension plan in the company's overall compensation structure may have changed significantly.

Although there may be some higher likelihood of asset reversions in the context of LBOs, we do not believe that it is appropriate at this time to restrict LBOs or to restrict the ability to recover excess assets as a means of reducing the number of reversions. First, the available data does not suggest that asset reversions happen only or predominately in the context of LBOs, or that LBOs arise only where there are excess pension assets. Second, the number and dollar volume of reversions generally has been falling steadily, and reversions are now occurring at only a fraction of the rate at which they were occurring at their peak in 1985. Accordingly, based on the evidence presently available, we do not believe that current pension policies encourage LBOs or that reversions occur only because of LBOs. Rather, we believe that changing the reversion rules would have little or no significant effect on the course of LBOs in the future, and that restricting LBOs would have little or no significant effect on the number of reversions in the future.

In our view, the tax treatment of excess asset reversions should neither be a significant impediment to LBOs nor a significant incentive toward LBOs and, although the issue is one that Congress and the relevant agencies should continue to monitor, we believe that it would be premature to take additional steps restricting an employers's ability to recover excess assets in response to the LBO phenomenon. The current law treatment of asset reversions attempts to strike a balance among the various goals of pension policy, i.e., to protect employees' retirement income security, to encourage the sound funding of plans, to encourage employers to establish and maintain pension plans for their employees, and to discourage the premature termination of these plans. The ability of employers to terminate their pension plans and recover excess assets, whether in the context of LBOs or other corporate transactions, is part of that balance. In addition, many of the current law rules affecting reversions--the new funding limitations, the excise tax on reversions, the excise tax on nondeductible contributions--were only recently enacted. Finally, the number of reversions has declined significantly, perhaps in response to some of the recent changes.

Defensive Use of Pension Plans. In the context of LBOs, and takeovers generally, it has become common to consider using employee benefit plans to defend against hostile takeovers. Such defensive tactics are of two basic types. One approach involves modifying existing defined benefit plans to eliminate any features of the plans that might be attractive to a hostile purchaser. A second approach involves establishing Employee Stock Ownership Plans (ESOPs) as a means of placing a significant portion of voting stock in the hands of employees who might be

less likely to tender their shares to a hostile bidder. Since this ESOP approach does not involve defined benefit pension plans, we will not address it in this testimony.

The defined benefit plan defensive approach most often involves amending a pension plan to adopt so-called "pension parachutes." Pension parachutes may take several forms. For example, the plan may be amended to provide that, in the event of a hostile takeover, additional pension benefits (or retiree medical benefits) are to be provided to plan participants, perhaps to the extent of any excess assets or simply at some fixed level above current benefits. Other potential defensive amendments of this type include provisions that would bar plan amendments without participant approval or bar plan termination altogether following a hostile takeover. As long as such amendments comply with the relevant requirements of ERISA and the Internal Revenue Code, we do not see any tax policy objection to the voluntary provision of additional retirement benefits and rights to employees.

This concludes my prepared remarks. I would be pleased to respond to your questions.

DEPARTMENT OF THE TREASURY

Report to the Congress

on

International Economic and Exchange Rate Policy

April 1989

DEPARTMENT OF THE TREASURY

Report to the Congress
on
International Economic and Exchange Rate Policy

April 1989

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PART I: INTRODUCTION

Section 3005 of the Omnibus Trade and Competitiveness Act of 1988 (Pub. L. 100-418) requires the Secretary of the Treasury to submit to the Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Representatives a report each October 15 on international economic policy, including exchange rate policy.

The initial report was submitted in October 1988 and provided an analysis of exchange market developments, including the underlying economic factors and the impact on the U.S. economy; an assessment of which countries were "manipulating" exchange rates within the meaning of the legislation; and recommendations for changes in U.S. economic policy to attain a more appropriate and sustainable current account balance.

Section 3005 also requires the Secretary to provide a written update of developments 6 months after the initial report. This report provides such an update. Part II reviews recent developments in the world economy, including developments in the U.S. balance of payments and efforts by the major industrial countries to coordinate economic policies. Part III analyzes the situation in the foreign currency markets, including the impact of changes in the exchange rate for the dollar on the U.S. economy. Part IV provides a status report on negotiations with Korea and Taiwan, economies which were considered in the October report to be "manipulating" their exchange rates, within the meaning of the trade legislation. The final part provides conclusions on the principal issues discussed in the report.

PART II: WORLD ECONOMIC PERFORMANCE AND OUTLOOK

Global Economic Developments

o Overview

The economic expansion in the industrial countries that has been underway for six consecutive years strengthened substantially in 1988, contributing to a very strong increase in world trade growth and helping the Less Developed Countries (LDCs) record their highest growth rate of the decade. In addition, the pattern of growth both within and among the seven largest industrial economies last year provided essential support for global current account adjustment. The U.S. current account deficit was reduced considerably in 1988 while the surpluses of Japan, the European Community and the four Asian Newly Industrialized Economies (NIEs) also declined. Consumer price inflation in the industrial countries picked up slightly again in 1988, albeit to a rate that was only slightly above the 20-year low reached in 1986. (See Table 1.)

The basically favorable macroeconomic trends that were evident in 1988 have generally persisted thus far this year, promoting confidence that industrial country growth will continue, albeit at a more moderate pace, at least into 1990. Partly as a result, the LDC economies and world trade should return to their more moderate 1987 growth rates.

However, the international pattern of growth will probably be somewhat less favorable for current account adjustment than was the case last year. Thus, while the external adjustment process is expected to continue in real terms in key countries, further large reductions in major current account imbalances are not anticipated this year.

The available evidence suggests that, while inflationary pressures bear close watching in some countries, the average industrial country inflation rate will pick up only modestly this year, to just below 4 percent. There is little evidence that a serious general acceleration of inflation is developing.

o Expansion Continuing at a Sustainable Pace

Real GNP rose 4.2 percent (annual average) in the seven largest economies in 1988. Expectations earlier in the year that the stock market break of October 1987 would have serious negative repercussions on industrial country macroeconomic performance were not borne out by events. Indeed, consumer and business sentiment improved substantially and generally remains good.

In addition to being stronger than initially anticipated, industrial country growth in 1988 was also better balanced internationally and therefore more supportive of global current account adjustment. In the United States, domestic demand growth was more moderate (3.0 percent) than in the earlier years of the current expansion, thus helping reduce the growth rate of nominal imports and making domestic productive capacity available to meet substantially higher foreign demand for U.S. products. The sharp improvement in U.S. net export performance last year accounted for nearly 1 percentage point of last year's 3.9 percent total GNP growth rate.

The Japanese economy, conversely, was led by a sharp increase in domestic demand while the external side exerted a strong net contractionary effect. Despite tax cuts in Germany, domestic demand growth was only slightly above GNP growth, and external developments had an essentially neutral impact. In the remaining major industrial countries, the difference between domestic demand and GNP growth was somewhat larger than was the case for Germany, particularly in the United Kingdom.

Growth prospects for the industrial countries remain favorable for 1989. GNP growth is projected to return to a more moderate and sustainable 3 to 3-1/2 percent range as private consumption growth moderates slightly and fixed investment slows from last year's exceptional pace. Japan will again be the G-7 growth leader for both GNP and domestic demand. In Europe, the growth slowdown is expected to be particularly evident in Germany and the United Kingdom.

The basic composition of industrial country growth outside of the United States this year (i.e., domestic demand growth in excess of GNP growth) is expected to be qualitatively similar to 1988. However, the projected slowdown of consumption and investment implies a more measured pace of domestic demand growth, which will narrow the amount by which it exceeds GNP growth.

o External Adjustment at More Measured Pace

One of the most favorable aspects of global economic developments in 1988 was the sharp increase in world trade growth, which both resulted from and contributed to the stronger and more balanced overall growth performance. The latest IMF estimates indicate that world trade volume increased by 9.3 percent in 1988 after a healthy 6.1 percent gain in 1987. This strong advance largely reflected developments in the industrial countries, which account for nearly 75 percent of total world trade.

These trade developments were reflected in significant shifts in the current account positions of major countries and country groups. The U.S. current account deficit declined about $20 billion, while Japan's surplus declined $7.5 billion and the combined surplus of the four Asian NIEs by about $4-1/2 billion, despite sharp growth in Korea's surplus. Europe's aggregate current account surplus was reduced by roughly $20 billion, though this was accounted for almost entirely by a very sharp increase in the deficit of the United Kingdom; Germany's current account surplus rose nearly $4 billion to a large record high of around $48-1/2 billion.

External adjustment in the major countries can also be gauged by considering current account imbalances as a percent of GNP, which eliminates valuation problems associated with exchange rate changes and takes into account the differing sizes of national economies. By this measure, the U.S. current account deficit declined from its 1987 peak of 3.4 percent of nominal GNP to 2.8 percent last year; Japan's surplus dropped from 3.6 to 2.8 percent (vs. its 1986 peak of 4.3 percent). Germany's surplus remained unchanged at 4.0 percent of GNP, though this was down somewhat from its 1986 peak of 4.4 percent.

Two emerging trends suggest, however, that while global current account adjustment is expected to continue this year, the pace of adjustment may slow somewhat. First, the projected narrowing in the difference between domestic demand and GNP growth in the major surplus countries will tend, ceteris paribus, to reduce the macroeconomic impetus for large additional shifts. Second, while U.S. export growth strengthened substantially in 1988, so too did export growth rates in most of the other major industrial economies, including the major surplus countries.

o Inflation Remains Modest and Contained

Consumer price inflation in the major industrial countries averaged about 3.1 percent in 1988, only slightly higher than the 2.8 percent recorded in 1987. Rates in Japan and Germany were exceptionally low, even by historical standards, averaging around 1 percent. France continued its impressive progress, holding its inflation rate below 3 percent. Rates in the United States and Canada both averaged near 4 percent, and around 5 percent in Italy and the United Kingdom.

Inflation rates in the major industrial countries have increased somewhat during the past 6 months, generating concern in some quarters about a potential serious deterioration on the price front. Average inflation in the industrial countries is expected to rise only modestly this year, however, probably remaining below 4 percent. While the situation bears close attention in some countries, some factors suggest that there is not now a serious risk of a general acceleration of inflation.

First, slower GNP and domestic demand growth this year will ease some of the demand-side pressure that may have been emerging last year. Second, and related to this, monetary authorities in the key countries have been pursuing policies of restraint. Third, despite some recent increases, unit labor cost developments have been quite moderate. Fourth, the OECD-wide surge in investment last year should help ease production bottlenecks that may be emerging in particular sectors.

U.S. Trade and Current Account Developments

o Developments in 1988

The U.S. trade deficit peaked in real terms in late 1986, and a year later in value terms. It then declined markedly in 1988.

The improvement in the U.S. trade deficit (nominal terms) in 1988 was broadly-based in geographical and product terms, and involved substantial increases in exports and slower import growth. For 1988 as a whole, the trade deficit declined by roughly $34 billion, from $160 to $127 billion, as exports grew strongly (28 percent in value terms), while imports grew less than one-third as fast. In volume terms, exports were up 23 percent, while imports increased 7 percent.

The trade deficit in 1988 decreased with every major geographic area, with the strongest declines vis-a-vis Western Europe, Latin America, and Japan. The improvement also covered a wide range of products. Only consumer goods, among major product groupings, failed to show a reduced defict in 1988.

Strong export growth was broadly-based in terms of both product categories and geographic regions. Past exchange rate changes played a major role in enhancing U.S. competitiveness in 1988. Our export competitiveness was complemented by strong domestic demand growth in industrial countries -- especially Japan -- and a revival of exports to Latin America, particularly to Mexico.

The more subdued rate of import growth for the United States in 1988 reflected in part the lagged effects of past exchange rate changes and lower average oil prices. Auto and consumer goods imports increased only slightly in 1988; a surge in these two categories had been a major contributor to the widening of the trade deficit during 1983-87. Capital goods was the one product category registering strong import growth in 1988, reflecting strong capital equipment spending by U.S. firms.

The pace of improvement in the trade balance, however, slowed in the last half of 1988. After remaining essentially flat at fourth quarter 1987 levels through the first three

quarters of 1988, import growth picked up in the fourth quarter of 1988, largely in finished manufactures. Export growth, though still robust, moderated somewhat in the latter part of 1988. Exports in the first half of 1988 were up over 32 percent in value terms from the first half of 1987, while second half exports were up 24 percent from the same period in 1987.

The U.S. current account deficit also declined in 1988, though less dramatically than the trade deficit, falling by roughly $20 billion, from $154 to $135 billion. This outcome reflected the net effect of the trade balance improvement discussed above, and a switch from surplus to deficit on trade in services. The adverse shift on the services account reflects the fact that the traditional U.S. surplus on investment income has been eroded, along with the U.S. international investment position, as borrowing from abroad has been needed to finance continued U.S. external deficits. (See Table 2.)

With respect to capital flows, the recorded net inflow in 1988 declined by about $17 billion, roughly equal to the decrease in the current account deficit. This was accompanied by a substantial shift from official to private net inflows. Official net inflows declined in 1988, while overall private inflows were unchanged. Within private capital, direct investment and securities transactions registered an increased net inflow, while banking inflows declined. By category, the largest changes in non-official flows were: increased foreign purchases of U.S. Treasury securities, more than offsetting a decline in purchases of other U.S. securities; a substantial decline in U.S. direct investment outflows; and a significant increase in net lending abroad by U.S. banks. (See Table 3.)

o Prospects for 1989

In view of recent developments, including higher oil prices and other factors, improvements in the U.S. trade deficit for 1989 which had earlier been expected may be partly offset. The outlook for trade and current account adjustment through the end of this year will be influenced by a number of major factors, in addition to oil prices. These factors include the prospects for sustained growth abroad, especially in Europe; exchange rate developments; progress with Korea and Taiwan on market opening and exchange rate adjustment; and sustained growth in major LDC export markets.

At home, success in reducing the budget deficit will be a critical counterpart to progress in these other areas. The recent bipartisan agreement on a budget framework for Fiscal Year 1990 between the President and the joint leadership of the Congress represents an important step in meeting the deficit reduction targets of the Gramm-Rudman-Hollings law.

Economic Policy Coordination

The major industrial countries are continuing their efforts to coordinate economic policies to achieve shared objectives. The coordination process has now become an accepted feature of the international economic landscape with regular meetings of finance officials from the Group of Seven countries (United States, Japan, Germany, France, United Kingdom, Canada, and Italy). A sign of the growing maturity and acceptance of the G-7 process, for example, was demonstrated by the meeting in February where no communique was issued and without the market instability that would have followed such a development in the past.

The recent meetings of the G-7 in February and again on April 2 have focused on efforts to maintain the substantial progress achieved in 1988 in dealing with global economic problems. Last year represented a notable success for the coordination process, as documented in the October report. Economic growth exceeded expectations and inflation remained in check. External imbalances were reduced substantially and exchange markets were generally stable.

However, sustained noninflationary growth -- which remains the central objective of the coordination process -- will require continued efforts. The success of these efforts depends on continued progress in controlling inflation and gradually reducing external imbalances. While reductions in external imbalances were achieved last year, further progress in this area is required.

- Countries with large fiscal and trade deficits, especially the United States, but also Canada and Italy, need to make further reductions in budget deficits to complement monetary policies. Implementation of the recent bipartisan budget framework agreement between the President and the joint Congressional leadership will be crucial to achieving further reductions in the U.S. budget deficit.

- The major surplus countries should pursue economic and structural policies that will sustain domestic demand growth without inflation and facilitate external adjustment; and

- All countries need to pursue structural reforms.

The coordination process has resulted in more effective arrangements to deal with exchange market pressures. As discussed in the next part of the report, exchange markets have been more stable over the past year, thus contributing to and benefitting from the progress in sustaining the global expansion

and reducing external imbalances. The G-7 agreed at their April meeting that a rise of the dollar which undermined adjustment efforts, or an excessive decline, would be counterproductive and reiterated their commitment to cooperate closely on exchange markets.

PART III: FOREIGN EXCHANGE MARKET DEVELOPMENTS

Overview

During the last 6 months, exchange markets have been generally stable. The dollar appreciated by about 5 percent against the Japanese yen and 4 percent against the German mark, but on a trade-weighted basis in nominal terms is little changed against major currencies. (See Table 4.)

Trends in exchange markets over this period can be subdivided into three distinct periods: 1) from October through mid-December when the dollar experienced selling pressure; 2) from mid-December through March when the dollar strengthened; and 3) since the beginning of April when the dollar eased from its end-March highs, but continues to be in good demand. Trading conditions throughout the period were influenced primarily by developments and market expectations regarding U.S. economic growth, inflation, monetary policy, and interest rates.

In market intervention, the U.S. monetary authorities made net purchases of about $0.7 billion from October through January. They purchased about $2.6 billion ($2.0 billion against yen and $0.6 billion against marks) to support the dollar against selling pressure during October-December, and sold about $1.9 billion against German marks in January as the dollar rose.

October through Mid-December

The dollar started declining in early October following evidence of slowing U.S. economic activity, which the market regarded as reducing the likelihood of monetary tightening. By mid-October, selling pressure on the dollar had emerged in response to diminishing prospects for higher dollar yields and market perceptions that U.S. monetary authorities might tolerate a gradual easing of the dollar ahead of the election, particularly because of concerns that adjustment of world trade imbalances was slowing. Furthermore, private analysts suggested that it would take a further dollar decline to narrow the U.S. external deficit. After the election, market attention shifted to concerns about the U.S. budget deficit, stimulating further dollar selling. Concerted intervention purchases of dollars by G-7 monetary authorities during the period made the market cautious about selling the dollar aggressively.

Mid-December through March

In December market sentiment changed, with participants taking the view that the G-7 monetary authorities would concentrate more on adopting anti-inflationary policies. Economic indicators showed that U.S. economic activity, though

moderating, remained robust. Dollar demand quickened on the market's belief that the Federal Reserve would tighten its monetary stance further. At mid-month, the Federal funds rate rose from under 8-1/2 percent to near 9 percent. However, in view of coordinated interest rate hikes in Europe, interest differentials favoring dollar placements against European currencies initially narrowed. There was no appreciable change in interest differentials against the yen.

Toward mid-January, the market turned increasingly bullish on the dollar. There was growing optimism regarding the United States' willingness to tackle its fiscal deficit. Also, "safe haven" demand related to tensions in the Mediterranean was appreciable. Meanwhile, comments from various G-7 officials were interpreted as indicating a tolerance for further dollar appreciation. Reports of concerted intervention sales of dollars during January and early February braked the dollar's upward momentum.

Subsequently, additional data interpreted as suggesting that inflationary momentum may have increased in the United States encouraged further expectations of monetary tightening by the Federal Reserve. Chairman Greenspan said that the Federal Reserve would err on the side of monetary restraint. The Federal Reserve progressively tightened the Fed funds to levels over 9 percent and, in late February, raised its discount rate by 1/2 percentage point to 7 percent. Meanwhile, Germany and Japan signalled that they would avoid further tightening of their monetary stances. Interest differentials against the German mark and the Japanese yen then began to widen significantly and, by late March, were approximately 1/2 percentage point higher than in late February.

Since End-March

After reaching its highs for 1989 in late March, the dollar eased back in early April. Following the G-7's statement of April 2 and subsequent reports of intervention sales of dollars against yen as well as marks, the market perceived that the G-7 monetary authorities would regard further dollar appreciation as counterproductive to global adjustment of external imbalances. Also, prospects for a further widening of interest differentials in favor of the dollar were viewed by market participants as mixed, given that U.S. economic indicators were seen as pointing tentatively to moderating U.S. economic activity.

Effects of Exchange Rate Changes on External Positions

Despite recent movements, the dollar remains roughly at 1980 levels in real terms. On average, the appreciation of the dollar in the early and mid-eighties against our major trading partners has been reversed.

Exchange rate changes since October have, on balance, been minor, and exchange rate changes in any case tend to influence the real economy with considerable lags. Thus, exchange rate developments over the past months probably have not been a significant factor affecting the U.S. economic situation and prospects. The influence of such minor exchange rate changes is extremely small, in comparison with the potential overall impact of other factors influencing the trade and current account position.

The October report noted several factors not captured by conventional models which could contribute to sustained reduction of the trade deficit over the long term. Strengthened competitiveness is much broader based than exchange rate calculations show. Intense competitive pressures during the period of dollar strength forced U.S. producers to make fundamental changes resulting in increased efficiency, reduced costs, and improved quality.

Also, direct investment in the United States should contribute to the adjustment process over time, especially in the automotive sector, with Japanese firms in particular expanding U.S.-based output (for export as well as import replacement), product lines and value added. However, the favorable indirect effects of past exchange rate changes on the trade balance resulting from direct investment activity are of a long-term nature. The modest exchange rate movements over the past 6 months have probably not affected these developments.

Finally, most trade models are based on assumptions of no policy changes. The essence of the G-7 coordination process is that policies are regularly reviewed, with an eye to possible changes in light of developments in the underlying fundamentals. The G-7 are committed to implementing the policies necessary to build on the progress that has been achieved.

PART IV: ASIAN NEWLY INDUSTRIALIZED ECONOMIES (NIEs)

Overview

The U.S. merchandise trade deficit with the Asian NIEs -- Korea, Taiwan, Hong Kong, and Singapore -- was $29.2 billion in 1988, 16 percent below 1987. This development reflected decreases in the bilateral deficits with Hong Kong (down 21 percent to $4.6 billion) and Taiwan (down 26 percent to $13 billion). As a share of the total U.S. trade deficit, the trade deficit with the NIEs increased slightly from 22 percent to 23 percent.

However, as noted in the last report, if the imbalance with Taiwan is adjusted to account for $2.5 billion (customs value) in gold Taiwan imported from the United States in the early part of 1988 for the purposes of diversifying official international reserves and reducing the imbalance, then the trade deficit with Taiwan fell by only 11 percent to $15.5 billion.

Under Section 3004 of the 1988 Trade Act, the Secretary of the Treasury is required to "consider whether countries manipulate the rate of exchange between their currency and the U.S. dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade." It was concluded in the October 1988 report that Taiwan and Korea engaged in such "manipulation," within the meaning of the legislation. Pursuant to Section 3004, the Treasury was required to initiate bilateral negotiations with Taiwan and Korea for the purpose of ensuring that these two economies regularly and promptly adjust the rate of exchange between their currencies and the U.S. dollar to permit effective balance of payments adjustment and to eliminate the unfair advantage.

Below is a summary of economic and exchange rate developments in Korea and Taiwan and the negotiations which have taken place with them since October. (See Table 5 on U.S. trade with Asian NIEs and currency changes.)

Korea

- Recent Exchange Rate Developments

The October report to the Congress and subsequent initiation of exchange rate negotiations with the Korean authorities stimulated a period of more intense appreciation of the won in late 1988.

- In the fourth quarter of 1988, the Korean authorities allowed nominal appreciation of the won to total 5.1 percent, compared with 2.5 percent and 1.3 percent in the second and third quarters.

- Most of this fourth quarter movement occurred in October and November, with the pace of appreciation slowing substantially in December.

Cumulative won appreciation in 1988 totalled 15.8 percent. This exceeded the movement against the dollar in 1988 of the currencies of Korea's key trade competitors, Japan and Taiwan. Thus, in 1988, the Korean won began for the first time to lose on a broad basis some of the advantage that it had gained for Korea earlier in the decade, and particularly since 1985.

Despite the won's strengthening in 1988, cumulative won appreciation still lagged behind that of the yen and New Taiwan (NT) dollar in key periods. For example, in the interval from the Plaza Agreement in September 1985 to end-1988, the won appreciated 34 percent against the U.S. dollar, compared with 49 percent for the NT dollar and 83 percent for the yen. Thus, the won maintained an important, albeit diminished, competitive edge.

In 1989, the authorities have generally maintained the slow pace of appreciation that they resumed in early December 1988. Won appreciation in the first quarter of 1989 totalled only 1.8 percent. However, late March and early April saw a brief period of somewhat more rapid movement of the won as the Treasury Department intensified its negotiations with Korea and the deadline approached for this report. Thus, as of mid-April, the won had appreciated 2-1/2 percent in 1989.

- <u>1988 Bilateral U.S. Trade Deficit with Korea</u>

According to U.S. customs data, the United States bilateral trade deficit with Korea increased 1 percent in 1988 to $9.0 billion, reflecting a 39 percent increase in U.S. exports to Korea and a 19 percent increase in U.S. imports from Korea. This is significantly slower growth than in 1987 when our bilateral trade deficit increased 39 percent (from $6.4 billion to $8.9 billion), based on a 27 percent rise in exports to Korea and a 33 percent rise in imports from Korea.

In the second and third quarters of 1988, the U.S. bilateral deficit with Korea was actually somewhat lower than in the same quarters in 1987. These declines were due primarily to a drop in the rate of growth of U.S. imports from Korea. This, in turn, was largely the result of the temporary impact of labor disturbances in Korea on production and exports. Growth in the bilateral deficit resumed in the fourth quarter of 1988, registering an increase of 5 percent over the fourth quarter of 1987.

o <u>Korean Global Balance of Payments Developments in 1988</u>

Korea's 1988 global trade surplus increased 51 percent to $11.6 billion on a balance of payments basis. Overall, exports grew 15 percent in volume terms, down from 24 percent in 1987. The growth of import volume, however, decreased even more sharply to 10 percent from 22 percent in 1987.

Toys are the only category of Korean exports that declined in value terms in 1988 (by 7 percent). Textiles and footwear -- other labor-intensive products about whose competitiveness the government expresses concern -- managed increases of 22 percent and 25 percent, respectively, despite won appreciation and higher wages. Exports of higher value-added products performed even more strongly: electronics were up 33 percent, iron and steel 35 percent, machinery 51 percent, automobiles 20 percent (despite second quarter labor disturbances), and ships 55 percent.

Korea's 1988 current account surplus increased 44 percent to $14.3 billion, compared with the government's $7 billion target. Thus, for the third consecutive year, the actual current account surplus was more than double the government's initial target for the year. Increases in net services and transfers -- reflecting declining external interest payments, Olympics-related tourism revenues, and transfers from Korean residents abroad -- contributed to the swelling of the current account surplus.

As indicated in Part II above, the magnitude of external imbalances is best judged by presenting the amount as a percentage of GNP. In this context, it is noteworthy that Korea's trade surplus increased from 6.5 percent of GNP in 1987 to 7.4 percent in 1988, while the current account surplus increased from 8.3 percent of GNP in 1987 to 9.1 percent in 1988. In contrast, Japan's 1988 trade surplus was equal to 3.3 percent of its GNP and its current account surplus, 2.8 percent, both having declined from 1987 to 1988.

With the rapid expansion of its current account surplus in 1988, Korea was able to continue reducing its external debt and building its foreign reserves, further strengthening its international position. Gross external debt fell to $31.2 billion (20 percent of GNP) in 1988, compared with $35.6 billion (30 percent of GNP) in 1987 and $46.8 billion (55 percent of GNP) in 1985. In addition, Korea increased its foreign reserves by nearly $9 billion to $12.3 billion in 1988; although equal to about 3 months' imports, this level is not excessive.

o <u>Domestic Economic Performance</u>

Korea's economy continued to boom in 1988. Real GNP growth exceeded 12 percent for the third consecutive year, bringing cumulative real GNP growth to 41 percent since end-1985. Domestic demand is strengthening -- due to large nominal wage increases, lower tariffs, and cuts in excise taxes -- but increased real net exports still accounted for nearly 50 percent of real GNP growth.

Unemployment averaged only 2.5 percent in 1988, the lowest annual average in the last three decades. Wages have increased by about 33 percent in the past 2 years. Cumulative productivity gains among production workers totalling about 30 percent in the past 2 years have largely offset the higher wages.

Monetary and price developments are increasingly showing the negative side effects of Korea's external imbalance. Despite tight credit controls and the government's direct efforts to sterilize the liquidity resulting directly from Korea's massive external surpluses, money supply expanded by about 19 percent in 1988. This, together with the large nominal wage increases and emerging capacity constraints, was largely responsible for the jump in inflation from 3 percent in 1987 to 7.2 percent in 1988.

o <u>Trade Developments in 1989</u>

Preliminary Korean customs data for the first quarter of 1989 show a substantial decline in Korea's global trade surplus relative to the same period in 1988. These data indicate that the global trade surplus totalled only $95 million in the first quarter of 1989, compared with $1.4 billion in the first quarter of 1988. Moreover, the won value of Korean exports declined by 4 percent in January and by 8 percent in February relative to the same periods in 1988, although in U.S. dollar terms, Korean exports increased by 11 percent and 6 percent, respectively, given the increase in the dollar value of the won in 1988.

For January-February 1989 (the latest period for which U.S. customs data are available), the U.S. bilateral trade deficit with Korea declined 28 percent, compared with the same period in 1988. U.S. exports to Korea increased 29 percent, while imports from Korea declined by 1 percent.

It is likely that Korea's first quarter trade performance reflects a compounding of seasonal factors (the first quarter is traditionally the weakest quarter in the trade account) and other unique influences:

- o Korean exporters accelerated shipments in the fourth quarter of 1988 in anticipation of continued strengthening of the won.

- o Korean importers, for their part, delayed clearing goods through customs in anticipation of the January 1, 1989, tariff cuts.

- o Together, these factors helped swell the 1988 fourth quarter trade surplus and produce an abnormally low surplus in the first quarter of 1989.

- o The increased level of labor disturbances so far this year is also temporarily suppressing Korea's export performance.

These seasonal or temporary factors notwithstanding, the preliminary data for early 1989 probably also reflect the beginning of a reduction in the underlying imbalance -- perhaps a significant reduction. Previous appreciation of the won, coupled with inflation and some trade liberalization, may have begun to contribute to a welcome structural reduction in Korea's external surpluses.

o <u>Evaluation of Recent Developments</u>

The won's appreciation against the U.S. dollar in 1988 was significant and reflected Korea's recognition of the need for the exchange rate to play a role in the adjustment process. The accelerated appreciation of late 1988, after negotiations were initiated, and more recently in the last few weeks, was a welcome response to our concerns. Nevertheless, cumulative won appreciation remains insufficient, judged against the magnitude of Korea's external surpluses in the past 3 years and the much greater appreciation of the currencies of Korea's competitors in the same period.

Korea's exchange rate policy this year appears to be based on the assumption that the trade data for the first quarter of 1989 foreshadow a drastic reduction in Korea's surpluses for the year as a whole. The indications that structural reduction in these surpluses may have begun are both welcome and hopeful. Nevertheless, the data are too preliminary and limited to indicate clearly such a trend, and in our judgment, do not justify the sharp deceleration in the pace of appreciation in most of the period since early December 1988. While some moderation in the pace of appreciation relative to the fourth quarter of 1988 appears understandable in the circumstances, continued appreciation of the won during the period ahead is nonetheless required to reinforce recent trade developments and ensure that the preliminary, first-quarter reduction in Korea's external surplus is, indeed, the first stage in a structural and lasting correction of the imbalance. If final trade data for the period ahead also show significant reductions in Korea's external surplus, the need for further won appreciation would be diminished.

The Treasury Department's negotiations with the Korean authorities since the October report appear to have produced some results. Cumulative exchange rate appreciation, however, remains insufficient and assurances of further appreciation that could be considered sufficient in the circumstances are lacking. In addition, Korea has not provided indications that it intends to move to a market-based system of exchange rate determination over the medium-term. Nor is Korea willing to engage in broader discussions on financial market liberalization. Thus, our judgment is that, within the meaning of Section 3004 of the Omnibus Trade and Competitiveness Act, Korea continues to "manipulate" its currency.

Our negotiations in the coming months will be aimed at obtaining assurances that exchange rate policy during the period ahead will reinforce the direction of recent trade developments. We will also seek to encourage the Korean authorities to dismantle the comprehensive capital and exchange controls that prevent market forces from asserting themselves in exchange rate determination.

Taiwan

Taiwan's external imbalances have undergone further positive adjustment since the last report. This is due, in large part, to the effects of currency appreciation, further reductions in trade barriers, and rising inflation and wages. If all of these elements, particularly further appreciation, continue this year, we would anticipate an additional reduction in Taiwan's current account surplus and its bilateral trade surplus with the United States in 1989.

Taiwan's global current account surplus also decreased by 43 percent in 1988 to $10.2 billion. As a proportion of GNP, this translates into a sizeable decline from 18.4 percent in 1987 to 8.3 percent in 1988. At the same time, Taiwan's overall trade surplus, excluding official gold imports from the United States, fell 26 percent in 1988 to $13.8 billion ($10.9 billion, including U.S. gold).

In the first 3 months of this year, compared with the same period last year, Taiwan's overall trade surplus was lower by 23 percent, excluding U.S. gold, but up 9 percent including U.S. gold. Moreover, domestic demand has replaced exports as the main source of growth for the economy. Real GNP growth was 7.3 percent in 1988, down from 11 percent in 1987.

Large U.S. exports of gold to Taiwan through August 1988 accounted for more than half of the reduction in the U.S. bilateral deficit with Taiwan. These exports have ceased and need to be replaced with an even greater value of other sustainable exports if the adjustment process is to be furthered

in 1989. In the last 6 months for which U.S. data are available (September 1988-February 1989), the average monthly trade deficit with Taiwan (excluding U.S. gold exports) has fallen 21 percent from the same period a year ago. Nonetheless, annualizing these data results in a trade deficit larger than last year's, or $13.9 billion. Clearly, this is still an unsustainable imbalance.

The New Taiwan (NT) dollar has strengthened by 49 percent against the U.S. dollar since the Plaza Agreement in September 1985, compared to 83 percent for the yen, 53 percent for the German mark, and 34 percent for the Korean won. However, in 1988 the NT dollar depreciated through October. Since the October report, the exchange rate has appreciated by 6-1/2 percent, mainly in 1989. Such currency appreciation is a positive development. Nonetheless, given the still large trade imbalance and the lack of currency appreciation throughout most of 1988, it appears that a continuation of the recent appreciation is required to advance the adjustment process.

During our recent negotiations with Taiwan (under the auspices of the American Institute in Taiwan and Coordination Council for North American Affairs) regarding its exchange rate policy, Taiwan agreed to take a number of important measures, including liberalizing its foreign exchange system and reducing capital controls. This liberalization could represent a potentially important step toward the establishment of a more market-based system of exchange rate determination.

It remains, however, too early to assess fully the effects of these measures. The effectiveness of the liberalization will depend importantly on how it is implemented and, specifically, on satisfactory resolution of uncertainties concerning: the extent of central bank intervention in the market; the continued free flow of trading information; the removal of remaining controls on capital inflows; and the potential for discrimination between Taiwanese and foreign banks. If these potential difficulties are promptly and fully addressed, the liberalization could be a major advance. If not, the new system could regrettably involve little real progress toward exchange rate liberalization.

o <u>Description of New Exchange Rate System</u>

Taiwan began to implement the new exchange rate system on April 3. Formerly, the NT dollar's value against the U.S. dollar was determined by the "middle rate" of interbank transaction rates on the previous business day, with a limit on fluctuation. The most important aspect of the new system is that all NT dollar-U.S. dollar transactions of $30,000 and above will now be freely determined. The exchange rate for small retail transactions under $30,000 will be determined by rotating

groups of nine foreign exchange banks (including foreign banks) based on the prevailing free market rates. Banks can then decide the exchange rate for small transactions based on this "reference rate." If the transacted rates fluctuate in excess of a certain level, then a new "reference rate" is determined with a wider band.

Given that the central bank could still intervene in the foreign exchange market through proxy state-owned banks, a significant reduction of central bank direct and indirect intervention will be essential to allow adequate scope for market forces. However, as announced and initially implemented, the new system does not permit openly ascertaining the level of official intervention. The Central Bank is using five local banks for intervention and information regarding transaction amounts and transaction banks will no longer necessarily be made available as it was in the past. Although the need for some discretion by the Central Bank is understandable, given the relatively small size of Taiwan's foreign exchange market, it need not have come at the expense of a normal degree of transparency for the system.

There are other operational problems with the new system. First, limits have been retained on banks "short" foreign exchange positions. Moreover, additional new limits were imposed on "long" foreign exchange positions. Initially these limits discriminated against foreign banks. Moreover, although foreign banks are to participate in the committee that determines the "reference" exchange rate, this has not yet appeared to be the case. We have indications that Taiwan intends to correct these problems, and will monitor the situation.

We are encouraged by the new foreign exchange system, which could potentially limit intervention. But, as noted above, its significance depends on its implementation. While we also welcome the appreciation of the NT dollar since the beginning of our negotiations, this appreciation, if not continued, will be insufficient against the backdrop of the lack of appreciation throughout most of 1988, which impeded the adjustment process. Therefore, further appreciation, of a sufficient magnitude, will be necessary this year.

Therefore, at this time, we are not yet able to alter our basic judgment that Taiwan, within the meaning of the legislation, "manipulates" its exchange rate. With full implementation of the new system, however, and further adequate exchange rate appreciation, it would be possible to review our position on this matter. Our negotiations in the period ahead will be aimed at prompt resolution of the problems that could limit the effectiveness of the new system as well as obtaining further sufficient appreciation of the NT dollar. It is important that Taiwan's currency more accurately reflect market forces and its external surpluses.

PART V: CONCLUSION

This report has provided an update of developments since October 1988, when the first report on international economic and exchange rate policies was submitted to the Congress.

Global economic performance has remained favorable in the intervening period. The economic expansion is continuing in the major countries, with the seventh year of consecutive growth following an extremely robust performance in 1988. Furthermore, in 1988, the lagged effects of exchange rate changes in 1986 and 1987 and the composition of demand in the major countries were conducive to significant reductions in external imbalances.

The pace of external adjustment has slowed, however. In view of recent developments, including higher oil prices and other factors, improvements in the U.S. trade deficit for 1989 which had earlier been expected may be partly offset. While inflationary pressures bear close watching, there is little concern that a general acceleration of inflation is developing.

The economic policy coordination process has contributed importantly to the improved performance of the global economy in the current expansion. Sustained noninflationary growth remains the central objective of the coordination process and will require continued efforts in reducing fiscal deficits, controlling inflation and gradually reducing external imbalances. In the United States, the recent bipartisan budget framework agreement between the President and the joint leadership of the Congress represents an important step forward in these efforts.

During the past 6 months, exchange markets have been generally stable. The dollar has appreciated slightly against some major currencies, but has been broadly stable on a trade weighted basis. These exchange market developments have, at most, had only a marginal impact on U.S. trade performance and would not be sufficient to change the outlook. The relative stability of exchange rates has made a welcome contribution to, and been supported by, the progress in sustaining global expansion and reducing external imbalances. The G-7 major industrial countries have agreed that a rise of the dollar which undermined adjustment efforts, or an excessive decline, would be counterproductive, and they have reiterated their commitment to cooperate closely on exchange markets.

In the October report, it was determined that Taiwan and Korea, within the meaning of the Section 3004 of the Omnibus Trade and Competitiveness Act of 1988, were "manipulating" their exchange rates against the U.S. dollar to prevent effective

balance of payments adjustment or gain unfair competitive advantage in international trade. In accordance with that section, the Treasury initiated bilateral negotiations with Korea and Taiwan for the purpose of ensuring that they regularly and promptly adjust the rate of exchange between their currencies and the U.S. dollar to permit effective balance of payments adjustment and eliminate the unfair trade advantage.

The appreciation of the Korean won since 1988 has been significant, and coupled with inflation and some trade liberalization, may have begun to contribute to a welcome structural reduction in Korea's external surpluses. Cumulative appreciation of the won, however, remains insufficient in view of Korea's overall economic performance and the large gap that exists between the appreciation of the won and that of the currencies of its major competitors. Korean authorities have slowed the won's rate of appreciation so far this year on the belief that first quarter trade data for 1989, showing a substantial decline in Korea's global trade surplus, portend a drastic reduction for the year as a whole.

In our judgment, these trade data are too limited and preliminary to indicate a clear irreversible trend towards a structural reduction in Korea's surpluses. Although, the Treasury Department's bilateral negotiations with Korea have produced some results, assurances of further adequate exchange rate appreciation are lacking. Moreover, Korea shows virtually no willingness to move to a market-based system of exchange rate determination over the medium-term nor to engage in broader discussions on financial market liberalization. Thus, within the meaning of the legislation, Korea continues to "manipulate" the won. Continued bilateral negotiations with Korea in the period ahead will be aimed at assuring adequate exchange rate cooperation in the near-term. Also, Korean authorities will be encouraged over the medium term to dismantle the comprehensive capital and exchange controls that prevent market forces from asserting themselves in exchange rate determination.

Taiwan's bilateral trade surplus with the United States and global current account surplus have declined. The NT dollar depreciated in 1988 through October, but has since appreciated somewhat. While this appreciation is welcome, further appreciation of a sufficient magnitude is required to advance the adjustment process, given the continued large trade surpluses and the lack of appreciation throughout most of 1988.

Taiwan's new foreign exchange system is an encouraging development, which could potentially limit intervention. The significance of the new system will, however, depend on its full implementation, and uncertainties exist as to the prospects for continued heavy central bank intervention to limit appreciation. Therefore, the basic judgment cannot yet be altered that Taiwan, within the meaning of the legislation, "manipulates" its

exchange rate. With full implementation of the new system and further sufficient exchange rate appreciation, we may well be in a position to review this judgment. Negotiations in the period ahead will aim at prompt resolution of the problems that could limit the effectiveness of the new system as well as obtaining further sufficient appreciation of the NT dollar.

APPENDIX

TABLES

1. Economic Performance of Key Industrial Countries

2. Summary of U.S. Current Account

3. Summary of U.S. Capital Account Flows

4. Measurements of Dollar Movements Versus G-7 Currencies

5. U.S. Trade with Asian NIEs and Currency Changes

Table 1

Economic Performance of
Key Industrial Countries 1/

	GNP Growth 2/		Domestic Demand Growth 2/	
	1987	1988	1987	1988
U.S.	3.4	3.9	3.0	3.0
Japan	4.5	5.7	5.2	7.7
Germany	1.8	3.4	3.1	3.7
France	2.3	3.4	3.4	3.7
U.K.	4.3	4.4	4.3	6.2
Italy	3.1	3.7	4.6	4.1
Canada	4.0	4.2	4.7	5.1
G-7 3/	3.4	4.2	3.7	4.4

	Inflation 4/		Current Account 5/	
	1987	1988	1987	1988
U.S.	3.6	4.1	-3.4	-2.8
Japan	0.1	0.7	3.6	2.8
Germany	0.2	1.2	4.0	4.0
France	3.3	2.7	-0.5	-0.4
U.K.	4.1	4.9	-0.6	-3.1
Italy	4.7	5.0	-0.1	-0.5
Canada	4.4	4.0	-1.9	-1.5
G-7 3/	2.8	3.1		

1/ All data are latest IMF figures, except for U.S.

2/ Real growth rates, annual average.

3/ Average of individual country rates weighted by GNP in dollar terms; annual averages.

4/ Consumer prices; annual averages.

5/ Calculated as percent of GNP; negative indicates deficit.

Table 2

SUMMARY OF U.S. CURRENT ACCOUNT
(MILLIONS OF DOLLARS, S.A.)

	Quarters								Annual		
	87:1	87:2	87:3	87:4	88:1	88:2	88:3	88:4	1986	1987	1988
Total Exports	56791	59864	64902	68014	75140	79443	81674	83648	223969	249570	319905
Agricultural	6486	7118	8287	7626	8910	9547	10213	9598	27357	29516	38268
NonAgricultural	50306	52746	56615	60387	66230	69896	71461	74050	196612	220054	281637
Total Imports	96662	99416	104567	109205	110327	109595	110844	115664	368516	409850	446430
Petroleum	8760	10075	12759	11288	9960	10257	9838	9236	34391	42883	39291
Non-Petroleum	87902	89341	91807	97917	100367	99337	101006	106429	334125	366967	407139
TRADE BALANCE	-39871	-39553	-39665	-41191	-35187	-30152	-29170	-32016	-144547	-160280	-126525
Partial Bal (Excl. Ag Exps & Pet imps	-37597	-36596	-35192	-37529	-34138	-29441	-29545	-32379	-137513	-146914	-125503
Net Services	5214	1825	678	12042	1336	-885	-222	4548	21027	19759	4777
Invest. Income	5076	1692	1067	12539	1128	-1986	-1234	4694	23143	20374	2602
Other Services	138	133	-389	-497	208	1101	1012	-146	-2116	-615	2175
Total Transfers	-2967	-3125	-2980	-4373	-3147	-2777	-3215	-4444	-15309	-13445	-13583
Remits & Pension	-867	-884	-855	-828	-908	-819	-872	-932	-3571	-3434	-3531
Govt Grants	-2100	-2241	-2125	-3545	-2239	-1958	-2343	-3512	-11738	-10011	-10052
NET INVISIBLES	2247	-1300	-2302	7669	-1811	-3662	-3437	104	5718	6314	-8806
CURRENT ACCOUNT	-37624	-40853	-41967	-33522	-36998	-33814	-32607	-31912	-138829	-153966	-135331

Source: Survey of Current Business

Table 3

SUMMARY OF U.S. CAPITAL ACCOUNT FLOWS
(MILLIONS OF DOLLARS, S.A.)

	Quarters								Annual		
	87:1	87:2	87:3	87:4	88:1	88:2	88:3	88:4	1986	1987	1988
US Reserve Assets	1956	3419	32	3741	1503	39	-7380	2272	313	9148	-3566
(Incr(-)Decr(+))											
Other Govt Assets	67	-170	252	1012	-814	-801	1990	3266	-1999	1161	3641
Foreign Official Assets	13977	10332	611	20047	24670	5946	-2534	10930	35507	44967	39012
Industrial	16561	17533	-926	16063	20814	6839	-3314	5557	29379	49231	29896
OPEC	-2801	-2681	-1723	-2750	-1375	-1783	-466	715	-9327	-9955	-2909
Other	217	-4520	3260	6734	5231	890	1246	4658	15455	5691	12025
Banks, net:	15770	-4461	29634	6304	-125	17847	1394	2268	19808	47247	21384
Claims	21870	-22422	-16519	-23460	17108	-13274	-27832	-33495	-59975	-40531	-57493
Liabilities	-6100	17961	46153	29764	-17233	31121	29226	35763	79783	87778	78877
Securities, net	13908	13479	9012	-6238	4799	16783	9806	7985	70481	30161	39373
Foreign Securities	-1639	-88	-972	-1757	-4467	1529	-1554	-2982	-4297	-4456	-7474
U.S. Treasury Securities	-2826	-2431	-2835	496	6887	5457	3412	4130	3809	-7596	19886
Other U.S. Securities	18373	15998	12819	-4977	2379	9797	7948	6837	70969	42213	26961
U.S. Direct Invest. abroad	-10691	-6220	-7870	-19676	-6509	511	-5196	-9241	-27811	-44457	-20435
Reinvested Earnings	-8663	-4932	-6300	-15776	-3636	-1525	-5519	-8749	-19708	-35671	-19429
Equity & Inter-co. Debt	-2028	-1288	-1570	-3900	-2873	2036	323	-492	-8103	-8786	-1006
For. Direct Invest. in U.S.	7979	7229	15026	11742	7347	13061	8395	13420	34091	41976	42223
Reinvested Earnings	1645	736	2081	-1925	3345	1093	1882	852	-2294	2537	7172
Equity & Inter-co. Debt	6334	6493	12945	13667	4002	11968	6513	12568	36385	39439	35051
Other U.S.-Corp., net	1205	4173	-331	248	1700	-6948	2399	n.a.	-7126	5295	-2849
Claims	-491	2603	-215	1248	-315	-7061	749	n.a.	-4220	3145	-6627
Liabilities	1696	1570	-116	-1000	2015	113	1650	n.a.	-2906	2150	3778
NET CAPITAL FLOWS	44171	27781	46366	17180	32571	46438	8874	30900	123264	135498	118783
Statistical Disc.	-6547	13071	-4399	16342	4428	-12624	23733	1013	15565	18467	16550
TOTAL *	37624	40852	41967	33522	36999	33814	32607	31913	138829	153965	135333

Source: _Survey of Current Business_

Table 4

Measurements of Dollar Movements
Versus G-7 Currencies Since Key Dates
Percent dollar appreciation (+) or depreciation (-)

as of April 12, 1988

Value of the dollar in terms of:	Since Floating Began 3/20/73 to date	Since Dollar Peak 2/26/85 to date	Since Previous Report 10/14/88 to date
Japanese yen	-49.6	-49.2	+4.0%
German mark	-33.2	-45.7	+3.5%
Sterling	+45.8	-38.3	+3.3%
French franc	+40.8	-40.0	+2.4%
Canadian dollar	+19.2	-15.3	-1.5%
Italian lira	+144.3	-36.3	+1.8%

Source: London midday rates.

Table 5

U.S. TRADE WITH ASIAN NIES AND CURRENCY CHANGES

U.S. Trade Deficit with Asian NIEs [1]
(U.S. $ Billions)

	1980[2]	1987[2]	1988[2]	%Change[3]
Hong Kong	-2.1	-5.8	-4.6	121%
Korea	0.2	-9.4	-9.5	n.a.
Singapore	1.1	-2.1	-2.2	n.a.
Taiwan	-2.8	-17.5	-13.0	369%
TOTAL NIEs	-3.6	-34.8	-29.2	722%
Total U.S.	-25.5	-160.3	-126.5	397%
% Total U.S.	14%	22%	23%	

[1] Totals may not equal sum of components due to rounding.
[2] U.S. balance of payments adjusted data.
[3] From 1980 to 1988.

Cumulative Change against US$ as of April 11, 1989 [1]

from:	7/22/80	9/20/85	end-87	10/14/88[2]	Rate on 4/11
HK$	-37.88%	0.41%	-0.30%	0.40%	HK$ 7.78
Won	-11.87%	34.01%	8.70%	6.41%	W 667.5
Singapore$	8.04%	12.49%	1.92%	3.28%	S$ 1.96
NT$	32.72%	49.39%	5.26%	6.55%	NT$ 27.12
¥	66.02%	82.51%	-6.84%	-4.72%	¥ 132.68
DM	-7.89%	53.07%	-15.32%	-4.30%	DM 1.89

[1] This table is calculated in terms of the movement of the foreign currency against the U.S. dollar, as this is the way the Asian NIEs measure their foreign currency movements. Thus, foreign currency appreciation is represented by a (+) and depreciation by a (-).
[2] Date of last foreign exchange report to Congress.

TREASURY NEWS

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

April 27, 1989

Statement by
Secretary of the Treasury
Nicholas F. Brady

The House Banking Committee vote today will restore the strong capital requirement in President Bush's Savings and Loan Reform Plan. Requiring S&Ls to put their own capital at risk ahead of the taxpayers' money is the only way to prevent in the future the unsound business practices that contributed to the current crisis. We commend the Committee for its actions and urge the Congress to move forward quickly to bring a bill to the President's desk.

NB-239

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

MAY

FOR RELEASE AT 12:00 NOON
April 28, 1989

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $9,000 million of 364-day Treasury bills to be dated May 11, 1989, and to mature May 10, 1990 (CUSIP No. 912794 UD 4). This issue will provide about $225 million of new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $8,786 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, Thursday, May 4, 1989.

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 11, 1989. In addition to the maturing 52-week bills, there are $14,833 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 $1,935 million as agents for foreign and international monetary authorities, and $6,733 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 $310 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 5176-3.

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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 one-half hour prior to the closing time for receipt of tenders 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.

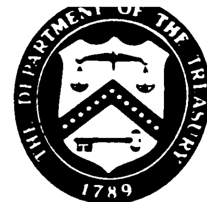
No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied 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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

'REASURY NEWS

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

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MAY 8 55 AM '89

DEPARTMENT

FOR IMMEDIATE RELEASE
April 28, 1989

Contact: Larry Batdorf
566-2041

TREASURY ANNOUNCEMENT
OF IRS NOTICE 89-58

On April 28, 1989 the Internal Revenue Service issued Notice 89-58 to provide taxpayers guidance on the allocation of bank loan losses for purposes of calculating the foreign tax credit. Notice 89-58 provides generally that all losses incurred by a bank with respect to loans made in the ordinary course of business will be spread among the various categories of interest income by reference to the bank's aggregate portfolio of loans. Loan losses will be spread among the categories of interest income without regard to the source of income to which the loan generating the loss would have given rise.

The Treasury Department today announced that if upon later review any significant modifications were to be made to the decisions reflected in Notice 89-58, in order to allocate loan losses more closely to the source of income produced by the loan generating the loss, such modifications would in no event have effect on losses realized on or before December 31, 1990.

NB-241

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-20

For Immediate Release

Remarks by
The Secretary of the Treasury
Nicholas F. Brady
U.S. Chamber of Commerce
Washington Hilton Hotel
Washington, D.C.
Monday, May 1, 1989

It is a pleasure to be here today for the U.S. Chamber of Commerce Annual Meeting. I'd like to begin with an announcement. This morning the Treasury Department informed the House and Senate leadership that we have ordered a delay -- to October 1 -- in the beginning date for testing plans for compliance with Section 89 regulations.

I have also asked the Congress to work with the Administration to find ways to revise Section 89 to make its requirements less burdensome to businesses.

Section 89, as most of you know, is the requirement of the 1986 tax reform act that health benefit plans be generally available to all employees in order for them to be considered a tax-excludible employee benefit. The fundamental logic behind the provision is unassailable. A system that differentiates between people in the matter of health benefits subsidized by the taxpayers cannot be sustained.

The authors of this law intended that it assure an equitable system of health benefits for all workers. But in attempting to issue the Section 89 regulations, the Treasury Department has found it imposes unreasonable compliance burdens on business. The cost of compliance with Section 89, as it presently stands, is excessive. The law needs to be changed, and we stand ready to encourage, support and work with Congress to revise and improve it.

Now I would like to turn to a discussion of some of the most difficult problems facing our country and the approach President

NB-242

Bush is taking to solve them. The goal of the Bush Administration's economic policy is to continue inflation-free economic growth. The approach President Bush has taken to meet this goal is: Tackle the tough problems. Find bipartisan solutions.

Last week marked the conclusion of President Bush's first 100 days in office. While the first 100 days are only a very early landmark in a four-year Administration, I believe the President has already demonstrated the kind of leadership that will be the hallmark of his Presidency and will ultimately mark him as a great President.

He is an action-oriented chief executive, deeply involved in the issues. He has the ability to seek out differing points of view, to listen, to consult, and utlimately to forge consensus. This enables him to accomplish things that conventional wisdom said could not be done, such as the agreement on aid to the Contras which he successfully negotiated with Congress. And it was this same open and responsive approach that enabled the Congress and the President to achieve consensus on a budget agreement just two weeks ago --the first time a President and Congress have ever reached such an agreement so early -- prior to all deadlines, and in a calm, rather than a crisis environment.

Some of our most effective Presidents, of both political parties, have possessed this same combination of leadership skills. President Lincoln forged an effective war-fighting team out of an Administration prone to division and conflict among itself. President Franklin Roosevelt was known for his willingness to listen to new economic ideas -- sometimes to the dismay of his more traditional advisors. And it was in Roosevelt's first one hundred days that he forged bipartisan consensus with Congress, on the 1933 emergency legislation that marked the beginning of our climb out of the depression.

Thanks to President Reagan's wise stewardship, we do not face today national crises on a par with those that confronted Lincoln and Roosevelt. But I believe the traits President Bush shares with these men make him the President to lead our efforts to solve the problems of our time.

When he took office, President Bush asked each of us in the Cabinet to face the issues squarely, propose fair and fitting solutions and work with Congress to implement them. That is exactly what we have done. At Treasury we have begun by clearing out the underbrush and some of the underbrush is sequoias.

Certainly one of the largest problems we faced at Treasury was the crisis in the savings and loan industry. President Bush has acted swiftly and forcefully to resolve the crisis. Just eighteen days after his Inauguration, the President came forward

with a comprehensive plan, and the Congress has acted swiftly on it. The Senate has already passed the legislation, and the House Banking Committee is currently in mark up.

The cost of solving the S&L problem is truly staggering -- $40 billion already spent and another $50 billion needed to resolve the remaining insolvent S&Ls. Our plan relies on a combination of industry and taxpayer funds. We propose that the industry provide as much financial support as is possible and still emerge a healthy competitive industry.

The plan is not a bailout for ailing S&Ls -- its purpose is to protect depositors' savings. In addition, it is a reform plan that is designed to ensure that the industry can never again sink into this kind of crisis.

The foundation of our reform plan is the requirement that S&Ls meet the same capital standards as national banks. That is, the owners of S&Ls must put their own capital at risk ahead of the taxpayers' money. It must be real, not phantom, capital. This is not an unreasonable request, and we must demand no less. If the minimum capital standard that the President proposes -- three percent tangible capital -- is adopted, two thousand Savings and Loans could meet it immediately. Those two thousand represent four out of every five of the solvent S&Ls in this country.

The principle behind our insistence on this point is simple: It is just plain human nature that an individual, any individual, is going to exercise more caution and careful judgement when he is putting his own money at risk. We should truly be ashamed if we put in place a solution to the S&L crisis that does not remove the conditions which would let it occur again.

The House Banking Committee has recognized this. It has courageously ignored the pressure of industry self-interest and required a minimum three percent tangible capital standard. This is the crucial element of the reform package. We taxpayers owe a great vote of thanks to the Committee -- and particularly to Chairman Gonzalez and Congressman Wylie -- for their resolve and commitment to solving this problem for once and for all.

The second major problem we have confronted at the Treasury is Third World debt. This one is simply too large for a "made in America" solution. The overall debt of developing countries is more than $1.2 trillion; the total commercial bank debt of the 15 largest debtors amounts to $275 billion. Only about 30 percent of the bank debt is held by U.S. banks. The rest of the bank creditors are located abroad. Thus, effective action will require a cooperative international effort.

Fortunately, we have seen in recent weeks broad support for

a new approach to strengthening the international debt strategy. This new approach represents the best ideas gathered from around the world. I put them forward on behalf of President Bush in a speech early in March and they were endorsed by the world's financial leaders at meetings here in Washington early last month. We are now in the process of implementing the new approach.

Our new ideas are aimed at easing the debt burden of developing countries. This will support their efforts to make their economies more responsive to market forces, thus generating higher growth, and a better standard of living for their people.

A dynamic process is underway -- debtor countries are already actively engaged with the commercial banks in devising a variety of ways to secure financial support in the form of debt and debt service reduction, as well as creative forms of new bank lending. New energy and ideas are being unleashed; but we are also seeing how tough this process is going to be. Both sides need to be more forthcoming and realistic in their expectations about what can be achieved in the initial round of this process.

The third major problem that we have tackled is the federal budget deficit. Just two weeks ago, President Bush reached agreement with the bipartisan leadership of Congress on a budget that will meet the Gramm-Rudman deficit reduction target for fiscal 1990 without raising taxes.

The budget agreement has been greeted as somewhat less than bold and heroic, and it may be. But it should not be dismissed lightly. It is the first time a President and a Congress have ever reached such an agreement before the first budget resolution required by the Budget Act. It does leave many details yet to be negotiated, but the negotiators have shown the determination and the good will needed to work out these details.

Most importantly, the agreement represents a promise by both sides to put aside their differences in the interest of fiscal sanity. The American people do not expect that we will have no differences. But they do expect us to be able to deal with our differences in the best interest of our country. This agreement shows the people -- and the financial markets -- that we can do so.

It is my experience that fiscal responsibility can lead to financial stability. When the Gramm-Rudman law was adopted in 1985, interest rates dropped three full percentage points in six months. If we show that we can meet the deficit reduction requirements of that law today, interest rates will come down.

The objective of our economic policies must be to continue strong, inflation-free economic growth. It is harder to meet

these objectives if our federal budget is out of control, so we simply must meet the Gramm-Rudman target, not only next year, but in subsequent years as well.

Now, many of you will have heard that the budget agreement calls for $5.3 billion in new revenue next year. This provision does not violate the President's pledge of no new taxes. The way to raise that revenue without raising taxes, is to cut the tax rate on capital gains.

However, the amount of revenue the capital gains cut will produce really is not the best argument for it. The other reasons for encouraging capital investment are much more compelling. The real objective of President Bush's proposal is not revenue, but economic growth. Jobs and opportunity are the most important results of a preferential tax rate for capital gains. A new factory built, a new medical cure, better quality products at lower prices -- that's what the capital gains tax is all about.

The underlying issue here, in fact, goes to the more fundamental problem of how we will preserve and improve our standard of living. How we will increase the rate of national saving and investment. How we will encourage Americans to take the long-term view in their economic thinking. How we will improve our international competitiveness.

The President stands firmly behind his capital gains proposal and I do too. The differential on capital gains will cut the cost of capital in the U.S. and bring us more in line with our international competitors, almost all of whom grant preferential tax treatment to capital gains. It is the responsible way to raise the bulk of the $5.3 billion we need to meet the Gramm-Rudman target for next year. But more than that, it is the right thing to do for the long-term health of our economy.

In sum, the Bush Administration is already deep in the midst of producing solutions to tough problems: The savings and loan crisis, Third World debt, the budget. And as you look around the Administration, the war on drugs, peace in Central America, education and the environment. President Bush has tackled them all and sought the help of Congress on each one. We need your help too. The Chamber is always one of the leading voices in Washington for responsible government. Thank you for that, and for the opportunity to be with you today.

TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-20

CONTACT: Office of Financing
202/376-4350

LIBR. ROOM 5310

FOR IMMEDIATE RELEASE

May 1, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

DEPARTMENT OF

Tenders for $7,009 million of 13-week bills and for $7,005 million of 26-week bills, both to be issued on May 4, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing August 3, 1989			:	26-week bills maturing November 2, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.61%a/	8.92%	97.824	:	8.57%	9.08%	95.667
High	8.65%	8.97%	97.813	:	8.65%	9.17%	95.627
Average	8.64%	8.96%	97.816	:	8.64%	9.16%	95.632

a/ Excepting 1 tender of $200,000.

Tenders at the high discount rate for the 13-week bills were allotted 59%.
Tenders at the high discount rate for the 26-week bills were allotted 14%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 37,710	$ 37,710	:	$ 26,995	$ 26,995
New York	20,933,670	5,826,910	:	20,471,430	5,915,870
Philadelphia	31,775	31,775	:	23,185	23,185
Cleveland	43,865	43,865	:	30,870	30,870
Richmond	72,545	57,545	:	40,565	40,565
Atlanta	40,010	40,010	:	27,640	27,640
Chicago	1,126,875	79,325	:	838,435	96,935
St. Louis	49,355	29,355	:	27,595	21,875
Minneapolis	7,610	7,610	:	8,675	8,675
Kansas City	41,095	41,095	:	52,085	52,085
Dallas	23,165	23,165	:	22,215	22,215
San Francisco	937,770	262,370	:	820,090	217,090
Treasury	528,065	528,065	:	520,735	520,735
TOTALS	$23,873,510	$7,008,800	:	$22,910,515	$7,004,735
Type					
Competitive	$20,629,945	$3,765,235	:	$18,145,510	$2,239,730
Noncompetitive	1,249,995	1,249,995	:	1,067,950	1,067,950
Subtotal, Public	$21,879,940	$5,015,230	:	$19,213,460	$3,307,680
Federal Reserve	1,961,625	1,961,625	:	1,850,000	1,850,000
Foreign Official Institutions	31,945	31,945	:	1,847,055	1,847,055
TOTALS	$23,873,510	$7,008,800	:	$22,910,515	$7,004,735

An additional $5,555 thousand of 13-week bills and an additional $359,345 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

'REASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-20
CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
May 2, 1989

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 May 11, 1989. This offering will result in a paydown for the Treasury of about $1,225 million, as the maturing bills are outstanding in the amount of $14,833 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 8, 1989. 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 February 9, 1989, and to mature August 10, 1989 (CUSIP No. 912794 ST 2), currently outstanding in the amount of $7,605 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,800 million, to be dated May 11, 1989, and to mature November 9, 1989 (CUSIP No. 912794 TD 6).

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

The bills will be issued for cash and in exchange for Treasury bills maturing May 11, 1989. In addition to the maturing 13-week and 26-week bills, there are $8,786 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 $1,454 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $1,764 million as agents for foreign and international monetary authorities, and $6,793 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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

M 5210

For Release upon Delivery
Expected at 11:00 a.m.
May 2, 1989

STATEMENT OF
DANA L. TRIER
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Committee:

I am pleased to be here today to present the Administration's views regarding H.R. 1864, which was introduced by Chairman Rostenkowski and others on April 13, 1989, to amend section 89 of the Internal Revenue Code. The Administration recognizes the enormous administrative burdens imposed on many employers by section 89. It is clear now that many of these problems were not fully understood when section 89 was enacted and that these problems cannot be properly addressed by regulations. Consequently, we agree with the Chairman that a complete revision of section 89 is necessary.

H.R. 1864 is intended to respond to many of the concerns taxpayers have expressed. The Administration applauds the efforts of the Chairman and the other sponsors of the bill to resolve the problems posed by section 89 and believes the bill sets the stage for legislative debate. We look forward to working with Congress during the course of the effort to develop a prompt legislative solution.

In the first part of my testimony, I will briefly describe the background of section 89, the policy rationale for its enactment and certain aspects of the proposed regulations. Then, I will summarize briefly the significant provisions of the bill. Finally, I will provide the Administration's preliminary views on certain provisions of the bill.

NB-245

BACKGROUND AND POLICIES

The Internal Revenue Code generally provides that the value of employer-provided health coverage is excluded from income. Section 89, however, conditions the availability of this tax benefit by providing that employer-provided health coverage may be excluded from the income of highly compensated employees only if coverage is also provided on a nondiscriminatory basis to nonhighly compensated employees. In the event employer-provided health coverage is found to be discriminatory under section 89, the value of coverage is included in the income of highly compensated employees as wages. The specific features of section 89 and the regulations thereunder are summarized in the description of the bill prepared by the staff of the Joint Committee on Taxation (JCT pamphlet), and I will not repeat them here.

The rationale for the conditions imposed by section 89 was that the tax expenditure for the exclusion from highly compensated employees' incomes is justified only to the extent employers provide nonhighly compensated employees health coverage generally comparable in value to the coverage received by highly compensated employees. The legislative history of the Tax Reform Act of 1986 indicates that Congress was concerned that the rules formerly applicable to certain employee benefits, particularly health insurance, did not require sufficient coverage of nonhighly compensated employees as a condition to the exclusion; it was thought that the tax benefit afforded to highly compensated employees receiving employer-provided health coverage could not be justified without nondiscriminatory coverage being mandated.

In promulgating proposed regulations under section 89, the Treasury Department and Internal Revenue Service attempted to be as flexible as legally possible to assist employers in bringing their plans into compliance with section 89. Thus, the proposed regulations provide several transitional provisions intended to allow employers to comply more easily with section 89 in 1989. First, the proposed regulations provide that employers who reasonably and in good faith comply with section 89 and its legislative history in 1989 will be treated as having satisfied section 89. The proposed regulations further provide that employers who elect not to test whether their plans satisfy the 75 percent benefits test in 1989 may include in the income of certain of their highly compensated employees all of the employer-provided health coverage. The highly compensated employees who must include in income all of the employer-provided health coverage are the 20 percent of such employees who receive the greatest compensation from the employer, but not less than ten employees nor more than 2,000 employees. This transitional provision is extended to 1990, except that the number of highly compensated employees who must include all of the employer-provided health coverage in income is greater. Finally, under the proposed regulations, an employer generally may choose

July 1, 1989, as the beginning of its testing year, and thereby ignore facts in existence prior to that date when testing its plans for compliance in 1989. Under this provision, an employer must annualize the benefits provided after July 1 to determine whether its plans are discriminatory.

Because we have become convinced that section 89 must be significantly restructured, the Department of the Treasury will do all it can to provide appropriate regulatory relief to minimize, within the confines of existing law, needless taxpayer compliance efforts under the current statute. In line with this policy, and in order to facilitate the legislative process, the proposed regulations will be modified to extend the beginning date for testing plans for compliance with the nondiscrimination rules in 1989 from July 1 to October 1. We hope that this step will provide Congress with sufficient opportunity to act before employers are required to expend substantial further resources to comply with the current statute.

SUMMARY OF H.R. 1864

H.R. 1864 responds to the perceived problems with section 89 in four ways. First, the complicated nondiscrimination tests of section 89 would be replaced by a two-part eligibility test and a benefits test. Second, certain modifications would be made to the categories of employees that must be considered for purposes of these tests, and the definition of highly compensated employees is changed. Third, the bill provides that the nondiscrimination rules applicable to group-term life insurance plans prior to the enactment of section 89 are to be applied to such plans, rather than the bill's new health nondiscrimination rules. Finally, while the bill would retain the so-called qualification requirements set forth in section 89(k), the sanction for failure to satisfy such requirements would be changed to an excise tax on the employer.

A. Nondiscrimination Tests

The first part of the eligibility test requires an employer to provide to at least 90 percent of its nonhighly compensated employees health coverage that is primarily core health coverage, at a cost to an employee of no more than $10 per week for employee coverage and no more than $25 per week for family coverage. The second part of the eligibility test requires that no health plan of an employer discriminate with respect to eligibility (by its terms or in operation) in favor of highly compensated employees. The JCT pamphlet states that the second part of the test is intended to preclude executive-only plans. The description further states that if at least 50 percent of the employees eligible to participate in the plan are nonhighly compensated employees, the plan is not an executive-only plan.

A health plan that satisfies both parts of the eligibility test is a "qualified core health plan." If the employer's health

plans are not considered, in the aggregate, to be a qualified core health plan, each highly compensated employee must include in income all of his or her employer-provided benefit.

If an employer's health plans pass the eligibility test, a portion of the value of the employer-provided health coverage must be included in the income of a highly compensated employee if such coverage does not satisfy the benefits test. The benefits test limits the amount of the tax-favored health benefits a highly compensated employee may receive to 133 percent of the value of the employer-provided coverage taken into account to satisfy the eligibility test.

B. Employees Taken Into Account and Definition of Highly Compensated

Under current law, the definition of a highly compensated employee is the same as that used for other employee benefits. The Internal Revenue Code generally defines a highly compensated employee as any employee who, during the current year or the prior year, is one of the following: (i) a 5 percent owner; (ii) an officer receiving compensation in excess of $45,000; (iii) an employee receiving compensation in excess of $75,000; and (iv) an employee receiving compensation in excess of $50,000, who is among those 20 percent of employees receiving the greatest compensation from the employer. The Code provides that the relevant dollar amounts will be indexed for inflation. In addition, an employer must have at least one officer who is considered a highly compensated employee, regardless of that officer's compensation. The bill modifies the definition of a highly compensated employee by providing that officers with compensation in excess of $45,000 are the only officers who must be considered highly compensated employees.

Under current law, an employer, when testing its health plans, generally may exclude those employees who have not completed six months of service, those who are not yet age 21, those who normally work less than 17 1/2 hours per week, those who normally work not more than six months per year and nonresident aliens receiving no United States source income.

The bill preserves the rules regarding minimum age and service conditions and nonresident aliens, but changes the definition of part-time employees and provides special rules for leased employees and employees covered by collective bargaining agreements. Part-time employees are those who normally work less than 25 hours per week. A leased employee generally may be considered an excludable employee if the leasing organization certifies to the employer that core health coverage is available to the leased employee at a cost that is no higher than $10 per week ($25 per week for family coverage). Finally, although the bill is somewhat unclear on this point, it appears that employees who are covered by a collective bargaining agreement may be disregarded in testing the health benefits available to an

employer's other employees. Similarly, other employees may be disregarded when testing the health benefits provided to employees covered by collective bargaining agreements.

C. Plans Covered

Under present law, group-term life insurance plans are subject to the section 89 rules, as well as health plans. In addition, an employer can elect to test certain other employee benefit plans, such as dependent care assistance programs, under the nondiscrimination rules of section 89. By contrast, the bill subjects only health plans to its new nondiscrimination rules and provides that the nondiscrimination rules in effect prior to the Tax Reform Act of 1986 will apply to group-term life insurance.

D. Sanction for Failure to Meet Qualification Rules

The bill replaces the current law sanction for failure to meet the so-called qualification requirements with an excise tax on the employer. It is unclear what amount is subject to the tax. The bill provides that the excise tax is to be equal to 34 percent of the amounts paid or incurred under the plan, similar to the present law requirement regarding the amount to be includable in an employee's income for such failure. The JCT pamphlet states the excise tax is to be equal to the cost to the employer relating to the coverage that failed a qualification requirement.

COMMENTS ON H.R. 1864

The Administration believes that the bill represents a positive step toward simplification of the rules applicable to employer-provided health and other benefits and, in particular, endorses its movement toward a design-based method for testing plans for nondiscrimination. We are especially pleased that H.R. 1864 would eliminate much of the data collection and record-keeping requirements of current law.

The Administration has not fully completed its review of the bill, and further time is necessary to explore fully the bill's practical impact. It is necessary to determine precisely how the tests will operate in the context of the wide variety of circumstances faced by employers, and, in particular, to assess the relationship between the tests and employees required to be considered. We are, however, prepared to make several preliminary comments at this time as to the areas that we believe need further consideration or clarification.

A. Nondiscrimination Tests

1. Eligibility Test

The foundation of the bill's eligibility test is the required availability of a health plan providing "primarily core

health benefits" at a cost to employees of no more than $10 per week ($25 per week for family coverage). The dollar amounts are indexed in accordance with the social security average wage index. It should be noted that, historically, health costs have been increasing more rapidly than wages. Although the bill does not define the term "core benefits," the JCT pamphlet states that major medical and hospitalization benefits are core health benefits and that dental and vision benefits and any health benefit provided under a salary reduction arrangement are not core health benefits.

The Administration believes employers should be permitted flexibility in choosing the types of health coverage they offer to their employees. The bill's provision for "primarily core health benefits" achieves this goal. Nevertheless, we agree with the JCT pamphlet that dental and vision benefits should not be considered core health benefits and urge Congress to provide in the statute itself that such benefits are not core health benefits.

The purpose of the dollar limitations on the amount an employer may require an employee to pay for qualified core health coverage is to ensure that affordable core health coverage is available to employees. The advantage of dollar limitations is to enable an employer, on an objective basis, to determine if it is offering health coverage to employees on a nondiscriminatory basis. At the same time, it is also important to assure that any dollar limitation does not reduce the availability of employer-provided health benefits.

To ensure health coverage remains affordable, the bill provides that the dollar limitations are indexed in accordance with the social security average wage index. The Administration supports the effort to make affordable health coverage available to employees and understands affordability is the rationale underlying the designation of a wage inflation index rather than a health care costs inflation index.

However, the impact of this method of indexing on employers' costs and on the overall cost of health coverage is not known. For example, it is uncertain whether the wage index would have the effect of increasing employers' costs, increasing co-payments and deductibles, or decreasing the quality of health coverage offered to employees. As a result, the Administration is not prepared at this time to state that this index is the best method of indexing the dollar limitations or that other affordability tests should not be considered. We will work with Congress to determine the proper approach as soon as practicable.

The second part of the eligibility test provides that the plan may not contain any provision relating to eligibility to participate that discriminates in favor of highly compensated employees. As noted above, the JCT pamphlet indicates that this test will not be met unless at least 50 percent of the group of

employees eligible to participate in the plan are nonhighly compensated employees. This rule should be modified to provide that a plan would be treated as satisfying the second part of the test if the percentage of highly compensated employees eligible to participate is no greater than the percentage of the nonhighly compensated employees eligible to participate in the plan. Absent such a change, an employer with a workforce comprised of a relatively large proportion of highly compensated employees might not be able to satisfy this part of the test.

2. Benefits Test

Under the benefits test, the value of the health benefits actually provided to a highly compensated employee that is more than 133 percent of the value of the benefits available to nonhighly compensated employees under a qualified core health plan is included in income. This test is simpler than the benefits test in section 89 because an employer is not required to keep records of the health coverage received by nonhighly compensated employees.

Nonetheless, the problem of health benefit valuation remains. The bill provides that value shall be determined under tables prescribed by the Secretary of the Treasury. The JCT pamphlet provides that until regulations are developed an employer may use any reasonable valuation method, including the cost of the premium as determined under the continuation coverage requirements applicable to group health plans.

Section 89 also directs the Secretary of the Treasury to prescribe health valuation tables. Employers argued that until valuation tables were developed, section 89 could not be implemented. Amendments to section 89 made by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) and the recently promulgated proposed regulations provide that any reasonable cost valuation method may be used to value benefits and that the cost of health coverage for purposes of the group continuation coverage requirements of section 4980B is deemed a reasonable cost valuation method. TAMRA and the proposed regulations provide that COBRA cost is a reasonable valuation method because the Treasury Department, despite considerable efforts, could not timely develop accurate, reliable valuation tables.

The Treasury Department believes it is in no better position today to develop valuation tables than it was when section 89 was enacted. Consequently, we urge Congress to provide in the statute that the value of health coverage is its cost or any other reasonable valuation method that the Secretary of Treasury may provide in regulations. This would provide certainty to employers and allow the Treasury Department to study further whether it is feasible to develop tables. To assist the Treasury Department in developing these tables, we request Congress provide appropriate authority and direction to other federal agencies that collect data regarding health care to share such

data with the Treasury Department for use in the developing valuation tables for health benefits.

3. Salary Reduction Contributions

The bill provides that salary reduction contributions are treated as employee contributions for purposes of determining whether the employee-paid portion of the premium exceeds $10 per week ($25 per week for family coverage). For purposes of determining whether health benefits provided to highly compensated employees exceed 133 percent of the qualified core health benefit provided to nonhighly compensated employees, salary reduction contributions are treated as employee contributions in the case of nonhighly compensated employees and employer contributions in the case of highly compensated employees. The JCT pamphlet states that salary reduction contributions are treated in this manner because they are truly a cost to the employee, and in a real sense are more costly for nonhighly compensated employees.

Although the Administration recognizes the policy reasons underlying the bill's treatment of salary reduction contributions, it believes the treatment of salary reduction contributions for purposes of the nondiscrimination rules needs further study. In particular, the treatment of such contributions for purposes of the benefits test should be examined to determine if there is an equitable way to treat such contributions made by highly compensated employees as employee contributions if, in fact, nonhighly compensated employees are receiving the same health benefits as highly compensated employees.

B. Small Business Considerations

The special circumstances faced by small businesses should be addressed in any legislation enacted to modify section 89. Businesses with less than ten employees often cannot purchase health insurance at group rates. Moreover, many small businesses have insurance contracts that do not provide for coverage for employees working less than 30 hours per week.

Congress should consider alternative ways in which small businesses that cannot purchase health insurance at favorable group rates may comply with the nondiscrimination rules. We believe the bill does not provide a satisfactory alternative for these businesses. For example, the $10 cap on the amount an employer may require an employee to pay for health coverage under a qualified core health plan may cause such businesses problems if any employee has health problems or if the employer's workforce is comprised of employees of significantly different ages.

The Administration suggests, therefore, that Congress consider permitting small businesses to satisfy the

nondiscrimination rules under alternative tests. A small business for this purpose would generally be defined as a business with ten or fewer employees. However, an employer with a larger number of employees could, under rules developed by the Secretary of the Treasury, be granted similar relief to the extent it was found that the employer faced similar circumstances in purchasing insurance.

We offer for your consideration this alternative. The dollar limitations on the employee-paid portion of the premium would not apply if: (i) a small business has only one health plan; (ii) the small business makes core health coverage available to 90% of its nonhighly compensated employees; and (iii) a majority of the nonexcludable, nonhighly compensated employees eligible to participate in the plan actually do so.

Many small businesses have insurance contracts that do not provide for coverage of employees who normally work less than 30 hours per week. The Administration believes it is advisable not to require employers with such contracts to make available health coverage to employees working less than 30 hours per week until the expiration of the current contract term.

Still other alternatives may be developed. The Administration urges Congress to consider all viable proposals that would enable such businesses to comply with whatever form the nondiscrimination rules may take in future legislation.

C. Applicability of Qualification Requirements

Congress should consider applying the qualification requirements only to health plans. This approach is sensible if the nondiscrimination rules are applicable only to health plans. Even if Congress rejects this approach, the Administration recommends that the qualification requirements not apply to no-additional-cost fringe benefits, employee discounts and employer-provided eating facilities. These fringe benefits are adequately addressed in section 132 and the regulations thereunder. Moreover, it is questionable, for example, whether employers should be required to maintain an employee discount program for an indefinite period of time or that an eating facility should be maintained for the exclusive benefit of employees.

D. Sanctions for Failure to Meet Qualification Requirements

H.R. 1864 replaces the current sanction for failure to comply with the qualification requirements of section 89 from an inclusion in employees' incomes of the values of the benefits provided under the plan to an excise tax on the employer equal to 34 percent of the amount paid or incurred under the plan. We whole-heartedly agree that the sanction for failure to comply

with these requirements should be imposed on the employer who caused the failure, not on employees.

Nevertheless, we perceive two problems with the proposed excise tax. First, it should not be applied to amounts paid or incurred under the plan. Such a provision would require an employer to know all of the health benefits provided under the plan to its employees during each year and the value of each benefit. The Administration recommends that the base to which the excise tax would apply be adopted in accordance with the description in the JCT pamphlet, i.e., the cost to the employer of providing the health coverage.

Second, we believe that a 34 percent excise tax may be too high. Consideration should be given to a two-tiered excise tax similar to the two-tiered excise tax imposed on certain transactions involving private foundations. Thus, a lower rate excise tax would be applied for each year in which the failure exists. If an employer did not correct the failure within a reasonable time after the failure is discovered, a higher excise tax would apply.

In addition, an employer may inadvertently fail to comply with one of the qualification requirements. For example, the employer may fail to provide a small number of its employees with the required notice of material plan terms. For this reason, any legislation that may be enacted should provide rules for de minimus failures or should give the Secretary of the Treasury authority to provide for such rules in regulations.

CONCLUSION

The Administration agrees that prompt Congressional action is needed to alleviate the problems employers are experiencing in complying with section 89. We believe the bill represents a major step forward in achieving these goals, but we are continuing to analyze the approaches taken in the bill to determine whether they represent the best solutions to the various issues posed. We are convinced that in order for any legislative response to be effective the statute must be made comprehensible and simple to administer. We are confident that through the legislative process our mutual goals can be achieved and the outstanding issues resolved.

This concludes my prepared remarks. I would be pleased to respond to your questions.

TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
Expected at 10:45 A.M., D.S.T.
May 2, 1989

STATEMENT OF THE HONORABLE NICHOLAS F. BRADY
SECRETARY OF THE TREASURY
SENATE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON TREASURY, POSTAL SERVICE
AND GENERAL GOVERNMENT
MAY 2, 1989

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE:

I am pleased to be here today to discuss with you the operating budget request for the Department of Treasury for Fiscal Year 1990.

Over the past few weeks, I have testified before the Senate and the House Budget Committees and Appropriations Committees as one of the Administration's economic spokesmen. We talked about President Bush's key budget proposals, including funding to win the war against drugs, to emphasize education and environmental issues, and plans to assist the homeless. We also talked about the Administration's plan to resolve the savings and loan crisis, important revenue related measures, and the need to improve our competitive position in the world economy.

My remarks, today, focus not on the economic and tax policy underlying the President's budget, but on that portion of the overall budget that pertains to the operations of the Department of the Treasury. As you are aware, the President's Fiscal Year 1990 Budget proposes freezing, at Fiscal Year 1989 levels, the aggregate spending of domestic programs not directly associated with one of his five broad initiatives. The Administration strongly encourages full funding of the Department's $0.5 billion request to continue the War on Drugs, including the increases proposed by President Bush to increase cargo inspections for drug smuggling and expand efforts to fight money laundering.

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Although most of our programs are included in the aggregate domestic discretionary spending category, the President has emphasized that the freeze is flexible, allowing some programs to increase while others are reduced. Discussions concerning increases or decreases to specific programs within the freeze category are ongoing between Congressional leaders and Administration officials.

The Department of the Treasury carries out a wide variety of functions that are critical to the functioning of our Nation's government. These activities include:

- Administering the Nation's tax system and collecting the revenues due under our tax laws;

- Managing the government's finances, by financing the debt, paying obligations, and maintaining the fiscal accounts;

- Collecting customs duties at our Nation's borders; interdicting illegal and dangerous drugs; and providing for the protection of the President and the Vice President; and

- Assisting the President in directing the Administration's domestic and international economic policies, monetary and financial affairs, and tax policies.

For Fiscal Year 1990, the Department is requesting a total of $8.0 billion and 155,748 full time equivalent positions for the purpose of carrying out these critical responsibilities. This request represents an increase of $311 million and 1,990 full time equivalent positions compared to Fiscal Year 1989.

I would like to highlight a number of objectives of our Fiscal Year 1990 budget request:

I. Our key priority is to maintain an effective tax administration system by transforming many manual, paper-intensive operations into a modern, automated system capable of delivering first quality service while processing returns and collecting revenues.

The Department's budget for the Internal Revenue Service, the largest Treasury bureau, takes account of the continued growth in tax administration workload and the pressing need for modernized systems. For the IRS, this entails pursuing the redesign of our current tax processing system--a system first introduced in the early 1960's, but today, aged and deficient in terms of available technology. This budget request will not only help guarantee the efficient collection of tax revenues through the turn of the century, but also will provide for the continuing improvement in service levels that the taxpaying public expects and deserves, reducing response times from weeks and days, in some cases, to a matter of minutes.

II. Our second objective is to maintain the ability of the Internal Revenue Service to promote tax compliance and collect revenue, while supporting improvements in these areas.

Improving service levels through modernization of tax collection systems will provide a necessary boost to our ability to promote tax compliance. However, the request for the IRS also contains the funds necessary to improve important, ongoing revenue enforcement activities. We propose to accomplish this objective by increasing resources for several high yielding revenue efforts, including the collection of unpaid taxes, compliance efforts among U.S. citizens living abroad, and investigations into possible underpayment of employment taxes.

Finally, we plan to augment the IRS' ability to perform examinations of tax returns where there are simple discrepancies that have a revenue impact.

The Bipartisan Budget Agreement for FY 1990 was approved last week by the President and the Congressional leaders of both parties. Incorporated into that agreement are $0.5 billion in additional revenues to be derived from expanded IRS tax enforcement efforts. To meet this target, additional resources will be required for IRS enforcement programs above the FY 1989 enacted levels. After the new resource requirements are determined, they will be provided to the Congress as part of the continuing negotiations on the FY 1990 budget.

III. A third objective is to support the President in his efforts to end the scourge of drugs by promoting the Department's role in drug law enforcement.

The role of the U.S. Customs Service in inspecting the people and goods crossing our Nation's borders places the Department of the Treasury at the forefront of President Bush's efforts to stem the tide of illegal drug trafficking. In Fiscal Year 1990, the Customs Service will continue to participate in drug enforcement task forces in major cities across the Nation and to increase drug interdiction efforts along our borders. The Department is requesting the additional resources to expand contraband examinations and improve automated systems that support investigative and intelligence operations. We also seek continued development and refinement of automated systems such as the Customs' Automated Commercial System to enhance productivity and improve the effectiveness of operations.

IV. Our next major objective is to fulfill our other law enforcement and protection responsibilities, including the continued enforcement of the Nation's trade laws.

The Department's budget requests funds for continuing law enforcement and support operations provided by the Federal Law Enforcement Training Center, the Customs Service, the Bureau of Alcohol, Tobacco and Firearms, and the Secret Service.

Considering Treasury's pivotal involvement in Federal law enforcement and our critical need to both hire and retain the most highly skilled law enforcement personnel, the Department supports the work of the National Advisory Commission on Law Enforcement. We need a fair compensation system, applicable to all Federal law enforcement personnel, to confront recruitment and retention problems, and to address the compensation issue as it relates to other Federal, state, and local law enforcement agencies.

We also remain committed to the concept of consolidated training in order to take advantage of scale economies and address the shared needs of our Nation's diverse law enforcement personnel. The request for the Federal Law Enforcement Training Center will support a facility that fully meets the basic and advanced law enforcement training needs of the participating agencies.

In addition to the drug interdiction efforts already mentioned, the Department proposes to provide funding for the Customs Service that will allow the collection of $19 billion in revenue through the enforcement of the Nation's trade laws. The Department's proposed funding will support the rapid inspection and clearance of 9.8 million formal merchandise entries and 370 million passengers.

We seek funds for the Bureau of Alcohol, Tobacco and Firearms to continue conducting programs to reduce the criminal use of firearms and explosives. In addition, funding the

operations of the Bureau will provide for the collection of an estimated $10.3 billion in excise taxes on alcohol and tobacco.

The proposed budget for the Secret Service takes into account the need for improved security at the Vice President's residence, vital upgrades to information and communications systems, and improved administration of responsibilities that include the protection of the President and the Vice President, and the investigation of currency counterfeiting, check forgery, and other types of fraud.

V. The Department's fifth objective is to continue to effectively manage the Nation's finances and service America's debt.

The request for the fiscal service bureaus--the Financial Management Service and the Bureau of Public Debt--furthers our efforts to improve governmentwide cash management, debt collection, financial information systems, customer service to holders of government securities, and the cost effectiveness of the Savings Bonds program.

As the lead agency for many of these issues, the Financial Management Service has presided over a substantial accomplishment--the generation of measurable savings of over $20 billion during the 1980's through more effective processing of the Federal government's $2.3 trillion annual cash flow. Over the last few years, the Financial Management Service has been called on to increase its leadership role in the financial management of the Federal government. The Service's proposed budget for Fiscal Year 1990 reflects this active role as well as the need to sustain the systems modernization necessary for ensuring financial management services in the future.

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

ROOM 5310
MAY 5

FOR IMMEDIATE RELEASE

May 2, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of October 1988.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $145.5 billion on October 31, 1988, posting a decrease of $621.2 million from the level on September 30, 1988. This net change was the result of decreases in holdings of agency debt of $370.3 million, in agency assets of $0.3 million, and in agency-guaranteed debt of $250.6 million. FFB made 32 disbursements during October.

Attached to this release are tables presenting FFB October loan activity and FFB holdings as of October 31, 1988.

NB-247

FEDERAL FINANCING BANK

OCTOBER 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
Note #473	10/7	$ 1,000,000.00	1/05/89	7.664%	
+Note #474	10/12	15,055,000.00	1/10/89	7.667%	
Note #475	10/14	2,000,000.00	1/11/89	7.706%	
TENNESSEE VALLEY AUTHORITY					
Advance #950	10/3	65,000,000.00	10/10/88	7.607%	
Advance #951	10/10	70,000,000.00	10/18/88	7.626%	
Advance #952	10/14	32,000,000.00	10/21/88	7.706%	
Advance #953	10/18	17,000,000.00	10/26/88	7.689%	
Advance #954	10/21	24,000,000.00	10/26/88	7.822%	
Advance #955	10/26	25,000,000.00	11/01/88	7.813%	
Advance #956	10/28	15,000,000.00	11/01/88	7.748%	
Advance #957	10/31	100,000,000.00	11/07/88	7.733%	
Advance #958	10/31	93,000,000.00	11/09/88	7.733%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 16	10/25	2,345,687.38	9/01/10	9.034%	
Greece 17	10/25	6,602,642.43	2/25/11	9.036%	
Morocco 13	10/28	4,054,325.12	11/30/93	8.523%	
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT					
Community Development					
Lincoln, NE	10/1	670,000.00	10/02/89	8.258%	8.428% ann.
*San Juan, PR	10/3	9,762,650.73	10/03/94	8.704%	8.893% ann.
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION					
Space Communications Co.	10/1	568,962,553.21	10/01/89	8.255%	8.425% ann.

*maturity extension
+rollover

FEDERAL FINANCING BANK

OCTOBER 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION					
*Wabash Valley Power #104	10/3	$ 8,704,000.00	1/03/17	9.064%	8.964% qtr.
*Wabash Valley Power #206	10/3	422,000.00	1/03/17	9.064%	8.964% qtr.
*Wabash Valley Power #206	10/3	186,000.00	10/03/90	8.557%	8.467% qtr.
Oglethorpe Power #320	10/6	15,804,000.00	12/31/90	8.575%	8.485% qtr.
New Hampshire Electric #270	10/6	225,000.00	1/02/18	9.064%	8.964% qtr.
*United Power #67	10/6	6,295,000.00	12/31/90	8.569%	8.479% qtr.
*Wabash Valley Power #104	10/11	8,809,000.00	1/03/17	8.892%	8.795% qtr.
*Wabash Valley Power #206	10/11	1,511,000.00	1/03/17	8.892%	8.795% qtr.
United Power #212	10/13	306,000.00	10/15/90	8.473%	8.835% qtr.
*Wolverine Power #182	10/13	2,595,000.00	1/02/90	8.259%	8.175% qtr.
*Wolverine Power #183	10/13	3,316,000.00	1/02/90	8.259%	8.175% qtr.
*Wabash Valley Power #206	10/27	140,000.00	1/03/17	8.996%	8.897% qtr.
*Colorado Ute-Electric #203	10/31	2,019,000.00	12/31/90	8.409%	8.322% qtr.
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-01	10/31	697,573,672.85	1/31/89	7.767%	

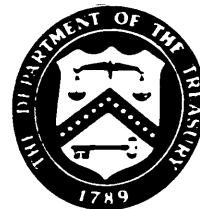
*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	October 31, 1988	September 30, 1988	Net Change 10/1/88-10/31/88	FY '89 Net Change 10/1/88-10/31/88
Agency Debt:				
Export-Import Bank	$ 10,957.6	$ 10,957.6	$ -0-	$ -0-
NCUA-Central Liquidity Facility	120.9	118.1	2.7	2.7
Tennessee Valley Authority	16,758.0	17,131.0	-373.0	-373.0
U.S. Postal Service	5,592.2	5,592.2	-0-	-0-
sub-total*	33,428.7	33,799.0	-370.3	-370.3
Agency Assets:				
Farmers Home Administration	58,496.0	58,496.0	-0-	-0-
DHHS-Health Maintenance Org.	79.5	79.5	-0-	-0-
DHHS-Medical Facilities	96.4	96.4	-0-	-0-
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,139.2	4,139.2	-0-	-0-
Small Business Administration	15.1	15.4	-0.3	-0.3
sub-total*	62,826.2	62,826.5	-0.3	-0.3
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	15,658.9	16,011.7	-352.8	-352.8
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	50.0	50.0	-0-	-0-
DHUD-Community Dev. Block Grant	316.2	318.1	-1.9	-1.9
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	2,037.0	2,037.0	-0-	-0-
General Services Administration +	387.5	387.5	-0-	-0-
DOI-Guam Power Authority	32.1	32.1	-0-	-0-
DOI-Virgin Islands	26.6	26.6	-0-	-0-
NASA-Space Communications Co. +	995.2	898.8	96.4	96.4
DON-Ship Lease Financing	1,758.9	1,758.9	-0-	-0-
Rural Electrification Administration	19,221.7	19,205.3	16.3	16.3
SBA-Small Business Investment Cos.	614.2	632.7	-18.5	-18.5
SBA-State/Local Development Cos.	866.7	870.9	-4.2	-4.2
TVA-Seven States Energy Corp.	2,176.3	2,162.4	13.9	13.9
DOT-Section 511	46.2	46.2	-0-	-0-
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	49,274.4	49,525.1	-250.6	-250.6
grand total*	$ 145,529.3	$ 146,150.5	$ -621.2	$ -621.2

*figures may not total due to rounding
+does not include capitalized interest

TREASURY NEWS



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

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE
May 3, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY MAY QUARTERLY FINANCING

The Treasury will raise about $11,400 million of new cash and refund $17,343 million of securities maturing May 15, 1989, by issuing $9,750 million of 3-year notes, $9,500 million of 10-year notes, and $9,500 million of 29-3/4-year 8-7/8% bonds. The $17,343 million of maturing securities are those held by the public, including $2,209 million held, as of today, by Federal Reserve Banks as agents for foreign and international monetary authorities.

The three issues totaling $28,750 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, Federal Reserve Banks hold $1,826 million of the maturing securities for their own accounts, which may be refunded by issuing additional amounts of the new securities at the average prices of accepted competitive tenders.

The 10-year note and 29-3/4-year bond being offered today will be eligible for the STRIPS program.

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

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Attachment

NB-248

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
MAY 1989 QUARTERLY FINANCING

May 3, 1989

Amount Offered to the Public	$9,750 million	$9,500 million	$9,500 million
Description of Security:			
Term and type of security	3-year notes	10-year notes	29-3/4-year bonds (reopening)
Series and CUSIP designation	Series S-1992 (CUSIP No. 912827 XM 9)	Series B-1999 (CUSIP No. 912827 XN 7)	Bonds of 2019 (CUSIP No. 912810 EC 8)
CUSIP Nos. for STRIPS Components .	Not applicable	Listed in Attachment A of offering circular	Listed in Attachment A of offering circular
Issue date	May 15, 1989	May 15, 1989	May 15, 1989
Maturity date	May 15, 1992	May 15, 1999	February 15, 2019
Interest rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids	8-7/8%
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	August 15 and February 15 (first payment on August 15, 1989)
Minimum denomination available ...	$5,000	$1,000	$1,000
Amount required for STRIPS	Not applicable	To be determined after auction	$1,600,000
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	$21.81975 per $1,000 (from February 15, 1989, to May 15, 1989)
Payment Terms:			
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment to be submitted with tender	Full payment, including accrued interest, to be submitted with tender
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
Deposit guarantee by designated institutions	Acceptable	Acceptable	Acceptable
Key Dates:			
Receipt of tenders	Tuesday, May 9, 1989, prior to 1:00 p.m., EDST	Wednesday, May 10, 1989, prior to 1:00 p.m., EDST	Thursday, May 11, 1989, prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):			
a) funds immediately available to the Treasury	Monday, May 15, 1989	Monday, May 15, 1989	Monday, May 15, 1989
b) readily-collectible check	Thursday, May 11, 1989	Thursday, May 11, 1989	Thursday, May 11, 1989

TREASURY NEWS

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

RM 5310

MAY 5

DEPARTMENT

FOR IMMEDIATE RELEASE

May 3, 1989

Statement by
The Secretary of the Treasury
Nicholas F. Brady

The House Banking Committee's 49-2 vote on legislation to reform the savings and loan industry is a significant step toward achieving a resolution of this crucial issue.

The House Banking Committee is to be commended for its action to provide strong capital standards for the savings and loan industry, including the phase-in of a three percent minimum tangible capital requirement. Sufficient private capital is essential to protect the American taxpayer. We also applaud the Committee action to approve the Administration's financing mechanism.

We do have serious concerns, however, about the nature and direction of amendments which reconfigure the Resolution Trust Corporation. The Committee has made substantial modifications which alter the original design and intent of the Administration proposal to manage insolvent savings and loan institutions at the lowest possible cost to the taxpayer. We are particularly concerned about provisions that would divert resources needed for savings and loan resolutions to housing subsidies.

With the Senate action completed two weeks ago, we urge the House of Representatives to act quickly so this legislation may be on the President's desk as soon a possible.

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TREASURY NEWS

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

MAY 5

FOR RELEASE AT 3:00 PM
May 4, 1989

Contact: Peter Hollenbach
(202) 376-4302

TREASURY ANNOUNCES ACTIVITY FOR
SECURITIES IN THE STRIPS PROGRAM FOR APRIL 1989

The Department of the Treasury announced activity figures for the month of April 1989, of securities within the Separate Trading of Registered Interest and Principal of Securities program, (STRIPS).

Dollar Amounts in Thousands

Principal Outstanding (Eligible Securities)	$326,960,162
Held in Unstripped Form	$239,787,572
Held in Stripped Form	$87,172,590
Reconstituted in April	$1,797,760

The attached table gives a breakdown of STRIPS activity by individual loan description.

The Treasury now reports reconstitution activity for the month instead of the gross amount reconstituted to date. These monthly figures are included in Table VI of the Monthly Statement of the Public Debt, entitled "Holdings of Treasury Securities in Stripped Form." These can also be obtained through a recorded message on (202) 447-9873.

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NB-250

TABLE VI—HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, APRIL 30, 1989
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding			Reconstituted This Month
		Total	Portion Held in Unstripped Form[1]	Portion Held in Stripped Form[1]	
11-5/8% Note C-1994	11/15/94	$6,658,554	$5,572,154	$1,086,400	—0—
11-1/4% Note A-1995	2/15/95	6,933,861	6,149,381	784,480	$2,560
11-1/4% Note B-1995	5/15/95	7,127,086	5,375,886	1,751,200	3,200
10-1/2% Note C-1995	8/15/95	7,955,901	7,005,901	950,000	2,400
9-1/2% Note D-1995	11/15/95	7,318,550	6,411,350	907,200	—0—
8-7/8% Note A-1996	2/15/96	8,410,949	8,100,549	310,400	—0—
7-3/8% Note C-1996	5/15/96	20,085,643	19,828,043	257,600	9,600
7-1/4% Note D-1996	11/15/96	20,258,810	19,825,210	433,600	38,400
8-1/2% Note A-1997	5/15/97	9,921,237	9,776,037	145,200	—0—
8-5/8% Note B-1997	8/15/97	9,362,836	9,362,836	—0—	—0—
8-7/8% Note C-1997	11/15/97	9,808,329	9,792,329	16,000	—0—
8-1/8% Note A-1998	2/15/98	9,159,068	9,158,428	640	—0—
9% Note B-1998	5/15/98	9,165,387	9,165,387	—0—	—0—
9-1/4% Note C-1998	8/15/98	11,342,646	11,341,046	1,600	—0—
8-7/8% Note D-1998	11/15/98	9,902,875	9,902,875	—0—	—0—
8-7/8% Note A-1999	2/15/99	9,719,678	9,719,678	—0—	—0—
11-5/8% Bond 2004	11/15/04	8,301,806	2,751,406	5,550,400	11,200
12% Bond 2005	5/15/05	4,260,758	1,725,608	2,535,150	—0—
10-3/4% Bond 2005	8/15/05	9,269,713	6,407,713	2,862,000	—0—
9-3/8% Bond 2006	2/15/06	4,755,916	4,755,916	—0—	—0—
11-3/4% Bond 2009-14	11/15/14	6,005,584	1,363,984	4,641,600	—0—
11-1/4% Bond 2015	2/15/15	12,667,799	2,925,559	9,742,240	215,200
10-5/8% Bond 2015	8/15/15	7,149,916	1,946,716	5,203,200	—0—
9-7/8% Bond 2015	11/15/15	6,899,859	3,005,459	3,894,400	147,200
9-1/4% Bond 2016	2/15/16	7,266,854	5,166,054	2,100,800	24,000
7-1/4% Bond 2016	5/15/16	18,823,551	11,962,751	6,860,800	412,800
7-1/2% Bond 2016	11/15/16	18,864,448	8,500,048	10,364,400	137,600
8-3/4% Bond 2017	5/15/17	18,194,169	7,715,289	10,478,880	362,400
8-7/8% Bond 2017	8/15/17	14,016,858	8,784,858	5,232,000	227,200
9-1/8% Bond 2018	5/15/18	8,708,639	4,753,439	3,955,200	—0—
9% Bond 2018	11/15/18	9,032,870	3,989,670	5,043,200	20,000
8-7/8% Bond 2019	2/15/19	9,610,012	7,546,012	2,064,000	184,000
Total		326,960,162	239,787,572	87,172,590	1,797,760

[1] Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form. The amounts in this column represent the net affect of stripping and reconstituting securities.

Note: On the 4th workday of each month a recording of Table VI will be available after 3:00 pm. The telephone number is (202) 447-9873.
The balances in this table are subject to audit and subsequent adjustments.

GPO 938-877

TREASURY NEWS

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

EMBARGOED FOR RELEASE UNTIL DELIVERY
Expected at 9:00 a.m., D.S.T.
May 5, 1989

Statement by the Honorable Nicholas F. Brady
Secretary of the Treasury
before the
Committee on Banking, Housing and Urban Affairs
United States Senate
May 5, 1989

Mr. Chairman and members of the Committee:

I welcome this opportunity to review the Administration's international economic and exchange rate policy and to discuss the issues raised in the latest Treasury Department report on this subject.

In particular, I would like to focus today on two aspects of U.S. international economic policy. First, our efforts to coordinate economic policies with other major industrial countries to achieve a growing world economy with low inflation, reduced trade imbalances, and greater exchange market stability. And, second, our bilateral negotiations with Korea and Taiwan to achieve economic and exchange rate policies in these newly industrializing economies that are compatible with their growing role in the global economy and their increased responsibility for maintaining an open world trading system.

Economic Policy Coordination

The economic policy coordination process is now an accepted feature of the international economic landscape. The Group of Seven (G-7) -- the United States, Japan, Germany, United Kingdom, France, Canada, and Italy -- meet regularly to review economic policies and performance. Measures to achieve shared objectives have been agreed and implemented. Close and continuous cooperation in exchange markets has contributed to more orderly currency arrangements.

Last year represented a notable success for the coordination process. Economic growth in the G-7 exceeded expectations and provided a strong impetus to world trade. Moreover, that growth was better balanced and supportive of a reduction in global trade imbalances, particularly a $34 billion decline in the U.S. trade deficit. While inflation picked up a bit in some countries, it remained modest and there was no evidence that generalized inflationary pressures were emerging. Finally, exchange markets were generally stable.

The strong performance in 1988 provides a sound basis for continued progress this year. Prospects are for solid growth in the major industrial countries in 1989, in the 3 to 3 1/2 percent range. The more moderate pace of private consumption and investment and the new productive capacity resulting from last year's investment will help to keep inflation pressures in check. Moreover, the basic pattern of growth has improved in the last 2 years. Domestic demand exceeds output in major surplus countries, whereas in the United States domestic demand is running below total output. This should contribute to a further reduction of global trade imbalances, although at a slower pace than during 1988.

The G-7 recognize that continued economic growth -- which remains the central objective of economic policy coordination -- requires that inflation be resisted where it is emerging and that external imbalances be reduced further. In countries with large fiscal and external deficits, especially the United States, further reductions in budget deficits are crucial. A reduction in the U.S. budget deficit through curbs on government spending would free resources for exports and investment. It would also help improve domestic savings and reduce the need for foreign savings. And, as importantly, it would demonstrate U.S. determination to tackle its own economic problems. Our efforts to get other countries to make the hard domestic choices that are necessary will succeed only if the United States demonstrates leadership and does its part by reducing the Federal budget deficit.

The recent bipartisan budget agreement is an important step forward. But our trading partners are skeptical. They want to see the proof, in terms of further reductions in the deficit. We -- the Administration and Congress -- must act promptly to implement fully the budget agreement and meet the Gramm-Rudman deficit reduction target for fiscal 1990. We also need to go further so that the deficit reduction targets for fiscal 1991 and beyond are met.

The reduction of trade imbalances requires effective action by both deficit and surplus countries. The surplus countries must also do their part by improving domestic demand growth, restructuring their economies to reduce dependence on exports, and removing barriers which prevent full foreign access to their markets.

Japan has undertaken a major effort to increase demand and is experiencing the fastest growth among the major industrial countries. Despite this growth and the effects of a significant past appreciation of its currency, Japan's trade surplus declined only modestly last year and is expected to be little changed in 1989. Clearly, further progress is needed to implement effective structural reforms that will open the economy to foreign goods and services and direct domestic production to the home market.

In Germany, progress has been less satisfactory. Despite some improvement in overall growth last year, the current account surplus rose to record levels and is expected to rise further this year as growth in domestic demand slows. More needs to be accomplished to encourage domestic growth and to remove impediments to investment and job creation.

Asian Newly Industrializing Economies

Responsibility for preserving a strong, stable world economy extends beyond the G-7. The newly industrial economies of Asia have benefitted greatly from an open, growing international trading system. They must also do their part to reduce global imbalances by allowing the value of their currencies to reflect the strength of their economies and bringing down barriers to trade and investment.

In the October 1988 report, the Treasury Department concluded that Korea and Taiwan were "manipulating" their exchange rates to gain a competitive advantage within the meaning of the 1988 trade act. As required by the act, negotiations with Korea and Taiwan have been initiated on their exchange rate policies.

These negotiations have resulted in some welcome progress. The currencies of both Korea and Taiwan have appreciated further, recent evidence suggests that a structural decline in their external surpluses may have begun and they are taking steps to open their markets and internationalize their financial systems. Nonetheless, we believe there is a need for more progress.

Last year, Korea's currency, the won, appreciated by nearly 16 percent, including about 4 percent in the 6 weeks following the release of the Treasury report in October. However, the adequacy of the won's appreciation in 1988 must be judged in light of much slower appreciation of the won in 1987 and the fact that in 1988 Korea's global current account surplus grew by 44 percent to $14.3 billion or 9.1 percent of GNP. Bilaterally, the U.S. trade deficit with Korea remained unsustainably large in 1988, at $9.5 billion, even though the deterioration slowed considerably due to stronger growth of our exports to Korea and decline in the rate of growth of our imports.

Preliminary data for the first quarter indicate a significant decline in Korea's trade and current account surpluses, including the imbalance with the United States. Unfortunately, the Korean authorities' response to these welcome developments has been to reduce sharply the pace of the won's appreciation this year. Since the beginning of the year the won has strengthened by only 2.7 percent against the dollar. Much of this occurred since late March, following another round of negotiations and the beginning of the preparation of our April report. We believe that the Korean current account data are too limited and preliminary to confirm that a trend toward a structural, lasting decline in Korea's external surpluses is underway. Thus, further appreciation is necessary to sustain and reinforce these recent welcome trade developments.

Towards this end, our negotiations with Korea in the coming months will be aimed at obtaining assurances of continued appropriate appreciation. Moreover, we will seek to engage the Korean authorities in a broad dialogue on their capital markets, including exchange controls and the banking and securities markets. Such discussions would be aimed at improving the efficiency and openness of these markets. In addition, we will seek to obtain an understanding that comprehensive capital and exchange controls used to manipulate the exchange rate would be dismantled over the medium term and that market forces instead would be allowed to determine the rate.

A reduction in Taiwan's external surplus also appears to be occurring. Last year, Taiwan's global current account surplus fell by 43 percent to $10.2 billion. Taiwan's trade surplus with the United States, which accounts for 95 percent of its global trade surplus, fell 26 percent to $12.7 billion, although more than half of this reduction reflected purchases of U.S. gold which have been discontinued. Preliminary data for the first quarter of 1989, however, point to further reductions in Taiwan's trade surplus with the United States.

In large measure these declines have resulted from the NT dollar's past appreciation. Moreover, since the October report, the currency has appreciated further, by roughly 12 percent, including about 5 percent since the release of the April report. We believe this will reinforce the positive trends in Taiwan's external surpluses.

Given the appreciation since the October report -- particularly following last week's release of our latest report -- and in light of recent trade data, there may be no need for further appreciation at this time. We will, however, continue to monitor Taiwan's trade and exchange rate developments closely to ensure that momentum toward external adjustment is sustained.

We will also monitor carefully implementation of Taiwan's new exchange rate system, without which the recent appreciation would not have occurred. This system, which the Taiwanese authorities proposed during our negotiations, has the potential for achieving a market-based exchange rate. However, implementation of the system is at an early stage and a number of operational problems remain which could severely limit the effectiveness of the liberalization.

Conclusion

In conclusion, Mr. Chairman, substantial progress has been achieved in recent years in promoting sustained noninflationary growth, reducing external imbalances and fostering greater stability of exchange rates. The major countries have a special responsibility to play in continuing this progress. Others, however, have a clear and complementary role to play. Our bilateral negotiations with Korea and Taiwan have achieved important progress that could set the stage for lasting, significant reduction in their external imbalances. In the period ahead, we will aim at ensuring that these economies play their appropriate role in promoting effective balance of payments adjustment and avoiding a competitive advantage in international trade.

TREASURY NEWS

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

Contact: Office of Financing
202/ 376-4350

FOR IMMEDIATE RELEASE
May 4, 1989

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,013 million of 52-week bills to be issued May 11, 1989, and to mature May 10, 1990, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	8.42%	9.12%	91.486
High -	8.44%	9.15%	91.466
Average -	8.44%	9.15%	91.466

Tenders at the high discount rate were allotted 44%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 28,510	$ 28,510
New York	30,583,665	8,321,285
Philadelphia	19,610	19,610
Cleveland	39,550	39,550
Richmond	33,275	33,275
Atlanta	30,790	29,230
Chicago	1,018,135	38,135
St. Louis	27,700	21,700
Minneapolis	19,535	19,535
Kansas City	50,890	49,890
Dallas	32,785	22,785
San Francisco	848,470	105,900
Treasury	283,870	283,870
TOTALS	$33,016,785	$9,013,275
Type		
Competitive	$29,422,010	$5,418,500
Noncompetitive	864,775	864,775
Subtotal, Public	$30,286,785	$6,283,275
Federal Reserve	2,600,000	2,600,000
Foreign Official Institutions	130,000	130,000
TOTALS	$33,016,785	$9,013,275

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TREASURY NEWS

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FOR RELEASE ON DELIVERY
EXPECTED AT 2:00 P.M.
THURSDAY, MAY 4, 1989

STATEMENT OF
ROBERT R. GLAUBER
NOMINEE FOR UNDER SECRETARY (FINANCE)
UNITED STATES DEPARTMENT OF THE TREASURY
BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman, Senator Packwood, distinguished members of the Finance Committee, I have the honor of being nominated by the President for the position of Under Secretary for Finance of the U.S. Treasury. It is an honor as well to appear before this Committee. I appreciate your making the time in your busy schedules to hold this hearing.

The responsibilities of my position include the Offices of Domestic Finance, Economic Policy, and Fiscal Management. Domestic Finance has primary responsibility for developing policies to deal with the capital and securities markets, financial institutions, and financial aspects of corporations. Economic Policy acts as economic advisor to the Secretary of the Treasury, participates in producing the Administration's economic forecast, and provides primary staff support on economic issues. These issues include the savings rate, retirement policy, and (together with the Office of Tax Policy) the impact of tax policy on corporate decisions. Fiscal Management acts as the government's financial manager, handling federal collections and payments and overseeing its central accounting and reporting systems.

I believe my experience as a teacher and researcher on finance issues at the Harvard Business School, as a consultant to financial institutions and business corporations, and as Executive Director of the Presidential Task Force empaneled to study the 1987 stock market break provides useful preparation for the duties for which I have been nominated.

I would like to take just a few minutes to outline some of the major policy issues with which I would deal if confirmed, apart from the current thrift crisis.

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International Competitiveness

It is perhaps stating the obvious to point out that the rapid internationalization of competition is one of the strongest forces confronting U.S. corporations, financial institutions and financial markets. If these institutions are to maintain and extend their competitive position and economic leadership, we must frame policies which take explicit account of these goals and give due consideration to the international arena in which these institutions must compete. As you know, the Secretary in a number of statements has directed attention to these concerns and intends to play an active role.

A. Leveraged Buyouts

At the beginning of this legislative session, this Committee held hearings on leveraged buyouts (LBOs), an issue which has important implications for the competitiveness of U.S. corporations. Contrary to forecasts that the 1986 tax rate reductions would sharply reduce the LBO business, the amount of such transactions has been rising. Is this trend a healthy one for U.S. corporations? In my view, judgement should be based primarily on whether or not LBOs contribute to the competitive position of U.S. corporations.

The arguments are many and are arrayed on both sides. On the positive side: management works harder when it owns a significant piece of the equity, high debt levels can act as an effective discipline on management, and private firms are not subject to the short-term performance demands of the stock market.

At the same time there are aspects of LBOs which are a basis for concern. First, more transactions are being done for companies in cyclical industries--chemicals, paper, etc. When the economy finally slows down, what will happen to these firms, not just their bondholders and stockholders, but also their workers and the communities in which the firms operate? Second, under pressure to service debt, heavily leveraged companies may cut back on R&D and capital expenditures--in short, they may become more short-term oriented when private than they were as public firms. Third, the level of LBO debt held by insured banks is growing, leading some to question whether sufficient due diligence has been performed. Finally, many of the brightest people coming out of college and business schools are spending more time recapitalizing old firms rather than rebuilding them or creating new ones.

The evidence on LBOs is ambiguous and incomplete. While aggregate debt levels are not beyond historical bounds, levels in certain industries and specific transactions can be cause for concern. Moreover, the recent LBO trend has gone on against a background of healthy economic expansion; how well will these

highly leveraged firms perform in a period of economic decline, where past history cannot be the guide?

My view is that any legislative initiatives at this stage should be limited, reflecting the inconclusive nature of the evidence. Some steps proposed by the Administration, though, would be useful to implement now--capital gains tax reductions, to encourage long-term investment decisions, and clarification of the ERISA laws, to indicate that pension fund trustees are not obligated to take a bid higher than current market price from fear of litigation.

A more sweeping and potentially more effective proposal would be to make dividends tax deductible, so that companies do not have tax incentives to replace equity with debt. The tax codes of virtually all other major industrial countries exempt dividends in whole or in part. But given the current size of the federal budget deficit, such a revenue reduction would be difficult to achieve.

The elimination of the tax deduction for some or all interest payments is an equally sweeping legislative initiative but, in my view, is overreaching. It would adversely affect the competitive position of U.S. corporations, by raising their cost of capital and by favoring foreign companies, which can use tax-deductible debt, in acquisition battles. Moreover, any attempt to eliminate the deduction for "bad" debt--for example, debt involved in "hostile" takeovers or raised by "excessively" leveraged firms--has and would produce definitional and administrative nightmares.

B. Financial Institutions

Several recent legislation initiatives have important implications for the competitive position of U.S. financial institutions. The secular decline in the profitability of these firms during the 1980's--commercial banks as well as thrifts--can be traced in some considerable measure to the competition from insolvent S&Ls which have been permitted to remain in operation. Continuing to compete in the marketplace, these institutions have pushed up deposit costs and reduced profit margins for commercial banks as well as other thrifts. The S&L legislation, which was recently and expeditiously cleared by the Senate, will resolve these institutions and reduce the pressure.

In the broader international arena, the position of U.S. banks has declined over the last two decades. In 1970, 7 of the world's 10 largest commercial banks, as measured by total assets, were U.S. firms. That declined to 3 of 10 in 1980 and none today. Several forces are at work, including the change in exchange rates, especially that of the yen-dollar, and the more concentrated structure of banking abroad compared to the U.S. But the restricted range of activities permitted to U.S. banks also has

played a role. The broadening of permitted commercial bank activities would enhance the competitive position of U.S. banks by stabilizing and increasing their profitability. And it would allow U.S. banks to meet their foreign competitors on a more level playing field, since a number of foreign banks operating in the U.S. are today permitted to engage in activities prohibited by Glass-Steagall to their U.S. competitors. Moreover, the experience some U.S. banks have developed abroad in these activities could be used to good effect at home.

As the financial services industry continues to evolve, it may well become clear that the distinction between commercial banks and thrifts has less economic meaning than one between smaller, "community" institutions and larger, "wholesale" institutions. That is, there may be more in common among most thrifts and the great majority of banks, all directed toward serving community, retail financial needs than between these banks and their multinational counterparts whose major focus is on the wholesale banking needs of corporations and similar institutions. If this does become the pattern of evolution, I believe it will have important implications for, and simplify the development of, legislation dealing with such issues as permitted banking activities and deposit insurance.

C. Securities Markets

Finally, how the markets for securities and related financial instruments develop has important competitive implications. The October 1987 market break revealed important weakness in both the institutional structure and regulation of these markets. Competition among the marketplaces for stocks, options, and financial futures is essential to continued capital market innovation in the face of increased pressure of global competition. But to operate efficiently and safely, these separate marketplaces must be part of a system which reflects, both in institutional structure and regulation, the economic functioning of one market.

There have been over the last year some positive developments in this area. Both the circuit breaker mechanisms developed jointly by the Chicago Mercantile Exchange (CME) and the New York Stock Exchange and the cross-margining discussions between the CME and the Chicago Board Options Exchange--initiatives of those private organizations themselves--enhance the integrity of the one market system. At the same time, little has been done to coordinate and integrate the clearing and settlement systems of these marketplaces. The October 1987 break demonstrated the brittleness of these systems and the damage to the broader financial system which could result from a rupture. An important agenda item must be work on clearance and settlement systems, to assure that the U.S. marketplaces relate effectively to one another and are integrated into the evolving global clearance and

settlement system. This issue will be high on the agenda of the Working Group on Financial Markets.

I would be happy to answer any questions the Committee might have on these or other issues.

TREASURY NEWS

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Remarks by
The Secretary of the Treasury
Nicholas F. Brady
At The Treasury Historical Association's
"Bicentennial Lecture Series"
The Cash Room
May 3, 1989

Thank you, "Joe" (Henry Fowler). Good evening guests, members and friends of the Treasury Historical Association. All of us share an appreciation of this building and the distinguished history of this Department. It is, as many of you know, the third oldest continuously occupied federal building in Washington.

A little more than a month ago, we began a public tour program here in the building. So from now on, the general public will have an opportunity to gain an appreciation for this historic building.

One of the highlights of the public tour will be a magnificent frame produced by the Bureau of Engraving and Printing in 1893. It was recently restored and unveiled earlier today as part of our Bicentennial Celebration. It now hangs in the West Lobby around the corner from this room. I encourage you to walk down there and take a look at it during the reception that will follow Paul Volcker's remarks.

The display was produced to honor the 400th anniversary of the Discovery of America. It was first exhibited at the Columbian Exposition, but it later was shipped all over the country to other fairs and shows.

My role this evening is to open officially the celebration of Treasury's Bicentennial Year. Two hundred years ago, the world's oldest Constitutional government got its start. Just this past Sunday, President George Bush travelled to New York to celebrate the 200th anniversary of George Washington's Inauguration as the first President of the United States.

Treasury's official beginning came in September of 1789, when it became the second Executive Branch agency. Our founding

fathers recognized that one of the first duties of any government is to provide a sound financial system for its citizens. The standard of leadership set by the first Secretary of the Treasury, Alexander Hamilton, still stands as the model for his successors.

Within months of its founding, the Treasury Department was by far the largest federal agency, both in numbers of staff and in its scope. Today's organization, with eleven bureaus, seems quite vast.

But in the early years many of the agencies that today provide services to the American people in other cabinet departments were situated at Treasury. Among them are the Coast Guard, the Postal Service, the Public Health Service, the Bureau of the Budget (now OMB), and the predecessor agencies of the Departments of Interior, Commerce and Labor.

We are beginning our Bicentennial celebration with a lecture series that will explore some of the themes of our history. The first lecture is taking place this evening in this room that itself is rich in history and symbolism.

Ulysses S. Grant, our 18th President, recognized this room's potential even before it was completed. He decided to have his inaugural ball, or reception as it was in this case, on March 4, 1869 in this room.

Traditionally, the evening festivities were in honor of the outgoing president and his successor. That year, the event was called a reception to avoid having to invite the unpopular ex-president, Andrew Johnson.

Two thousand invitations were sold, slightly less than the 80,000 invitations sold for President Bush's inauguration. Each ticket admitted one gentleman and two ladies.

Unfortunately, the event wasn't particularly well-planned. The lack of any kind of coat check system caused, as one headline read, "A WILD HUNT FOR OVERCOATS." Many of the guests had to wait until 4:00 a.m. to retrieve their wraps and some clever people entered the cloak room on the fourth floor through a transom above the door of an adjacent room.

Now, before I turn the microphone back to "Joe", I want to thank the Treasury Historical Association's board for the ambitious program they are planning for this year. They began with the Bicentennial Calendar that details the Department's achievements day-by-day. In addition to tonight's lecture, they have scheduled four more -- on international trade, economic growth, historic preservation, and the history of American tax policy.

Next fall, "Joe" Fowler will join several other former Secretaries in a discussion of their roles and accomplishments. And finally, in September, we're planning a gala birthday party.

Thank you all for coming this evening. It's a pleasure to see the distinguished former Chairman of the Federal Reserve Board, Paul Volcker, here at Treasury. Now, I'd like to ask "Joe" Fowler to introduce our distinguished speaker.

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